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Report of the Auditor General of Canada to the House of Commons

FALL

Matters of Special Importance

Main Points—Chapters 1 to 9

Appendices

Office of the Auditor General of Canada



2010



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Main Points—Chapters 1 to 9

Appendices

Office of the Auditor General of Canada

The Fall 2010 Report of the Auditor General of Canada comprises Matters of Special Importance, Main Points—Chapters 1 to 9, Appendices, and nine chapters. The main table of contents for the Report is found at the end of this publication.

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Auditor General of Canada
Vérificatrice générale du Canada

To the Honourable Speaker of the House of Commons:

I have the honour to transmit herewith this 2010 annual report to the House of Commons, which is to be laid before the House in accordance with the provisions of subsection 7(3) of the *Auditor General Act*.

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

OTTAWA, 26 October 2010

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Matters of Special Importance—2010

Matters of Special Importance—2010



Sheila Fraser, FCA
Auditor General of Canada

As the end of my 10-year mandate as Auditor General approaches, I am pleased to present my tenth and final Fall Report to the House of Commons. The Commissioner of the Environment and Sustainable Development will be presenting a separate report later this year.

Next spring, in addition to a Status Report, I will present a report to Parliament focusing on how the Office of the Auditor General of Canada has evolved over the last 10 years to better serve parliamentarians.

My Office audits federal government operations and provides Parliament with independent information, advice, and assurance regarding the federal government's stewardship of public funds.

The federal public service is a vast and complex organization that is tasked with managing a multitude of activities, programs, and issues on behalf of Canadians. The range of topics covered in this report shows the variety of responsibilities that federal public servants are expected to fulfill. We are often asked how we choose what to audit from among the vast range of activities and programs.

We select what we audit by identifying areas of greatest risk. Risk-based planning focuses on how well an organization is managing the risks that are critical to its success rather than simply focusing on areas of suspected weaknesses. In other words, we audit matters that are significant to Parliament and to Canadians, and we report what we find, both the positive and the negative. While audits that are perceived as more critical are likely to garner more attention, positive findings are equally important because they provide assurance that government is managing well.

As part of our risk-based planning, we consult senior departmental officials to find out what they consider to be their areas of greatest risk. This type of consultation helps ensure that our reports focus on important areas that are critical to the delivery of programs and services. It also helps ensure that any recommendations we make are useful to management and therefore more likely to be implemented.

The Office also considers requests from Parliament and its committees in planning its work. For example, the request to review the acquisition of the Chinook and Cyclone military helicopters came from the Standing Committee on National Defence. And what we found in that audit is troubling.

Given the cost and complexity of military acquisitions, how they are managed is subject to a number of policies, rules, and controls. This demanding acquisition process has been designed to ensure that the equipment and services purchased meet the identified needs and are delivered not only on time and within budget, but also in a way that enhances access, competition, and fair treatment of suppliers.

Our audit of the Acquisition of Military Helicopters (Chapter 6) found that these policies, rules, and controls were not respected. In particular, the way the advance contract notification instrument was applied in the directed procurement of the Chinook helicopters did not comply with the letter or intent of the applicable regulations and policies. In our opinion, the contract award process was not fair, open, and transparent.

Further, National Defence did not develop full life-cycle plans and costs for the helicopters in a complete and timely way. Buying helicopters is only one part of providing the Canadian Forces with the capability to perform missions. Other elements are required, such as qualified and trained personnel to operate and maintain the helicopters, hangars to house them, and spare parts over the life of the aircraft. Some of these elements are not in place, and costs have yet to be completely estimated. Adequate cost information enables the Department to plan to have sufficient funds available over the long term to operate and support the helicopters. In this case however, it may have to curtail planned training and operations.

The procurements of the Chinook and Cyclone helicopters underscore the need to recognize that acquiring such complex equipment carries unique risks and challenges that need to be properly managed, using an appropriate procurement strategy.

While the findings of this audit are cause for concern, it is important to note that the majority of the audit findings presented in this report are positive.

For example, Chapter 1 of this report deals with Canada's Economic Action Plan (EAP), the government's response to the global economic downturn. This initiative involves about $47 billion in federal stimulus over a two-year period, with a further $14 billion from the provinces and territories. More than 35 federal entities worked with provinces, territories, municipalities, non-government organizations, and the private sector to deliver close to 90 programs under the EAP. Our audit looked at selected programs to determine whether they were set up in a timely way and with appropriate safeguards. We found that the

government put in place appropriate practices and that it approved projects in a timely manner. Capacity to deliver the EAP within the short time frame created additional risks for departments, and senior management implemented additional controls to manage these risks.

It is encouraging to note that when tasked with rolling out a complex and time-sensitive initiative, central agencies and departments worked together to achieve timely implementation while paying considerable attention to risk and ensuring eligibility criteria were met.

It should be noted that we audited the Economic Action Plan as it was being delivered. Consequently, we did not audit the full implementation or the results of the Plan. Our Office is preparing a second audit of the EAP, to be reported in fall 2011. That audit will focus on program delivery and whether selected programs and projects undertaken under the EAP were completed as intended. Our work may also include an examination of the information collected on projects and whether this information was sufficient for federal entities to assess progress toward the objectives of the Economic Action Plan.

Chapter 5, Regulating and Supervising Large Banks, looks at how the federal government regulates and supervises Canada's six largest banks. Banks exercise key economic functions: they make and settle payments for almost all transactions taking place in the economy, they participate in capital markets to finance their lending activities, and they bring together lenders and borrowers. The way banks borrow funds, combined with the risks involved in their lending activities, can potentially threaten their solvency. When this happens, the public's confidence in financial institutions is shaken, which in turn threatens the stability of the financial system. Regulation and supervision are meant to mitigate this risk.

According to experts, compared with those of many other countries, Canada's banks fared well during the recent global financial crisis. They attribute this in part to the way Canada regulates and supervises its banks. The Canadian approach includes effective communication among federal organizations. Our audit found that during the recent financial crisis, this ongoing exchange of information among key players allowed for timely and informed decision making and contributed to Canada's relative success. We found that the Canadian approach also includes updating legislation, regulations, guidelines, and the supervisory process to keep pace with domestic and international developments. The challenge facing Canada now is to maintain its advantage at a time when new international standards are

being introduced, banks are innovating and their operations are becoming more complex, and financial markets are rapidly evolving.

The federal government delivers a broad range of services that have a direct impact on the well-being of individuals and organizations across the country and abroad. These services range from answering questions about income tax to issuing social benefit payments and renewing passports. At some point in his or her life, every Canadian interacts with the government to access services.

Our audit of Service Delivery, reported in Chapter 3, found that two organizations we examined are taking appropriate measures to ensure the quality of their services. Human Resources and Skills Development Canada and the Canada Revenue Agency—the two federal organizations that interact the most with the public—deliver large, complex, and ongoing programs that have a critical impact on the well-being of numerous Canadians.

Both Human Resources and Skills Development Canada and the Canada Revenue Agency are working to continuously improve service delivery and to provide Canadians with the high-quality service they expect from their government. For example, they assess clients' needs and expectations, monitor their own performance against service standards, and report on their performance. By using such methods, they are able to track progress and to determine what is working and what is not, and what they need to change.

Conclusion

This report is evidence that when senior officials give priority to large initiatives like the Economic Action Plan, public servants rise to the challenge. It shows not only that government is able to pull together and react quickly to urgent and unforeseen situations such as the global economic downturn, but also that it does a good job of managing the delivery of ongoing large and complex programs such as Employment Insurance and child and family benefits. Our positive findings speak to the effort that public servants put into ensuring that they serve Canadians well and look for ways to continuously improve.

I hope that parliamentarians find the information in this report useful.

In closing, I want to thank my staff for their professionalism and continued dedication to the Office and the Parliament we serve.

Main Points—Chapters 1 to 9



Canada's Economic Action Plan

Chapter 1 Main Points

What we examined

In late 2008 and early 2009, Canada was in the midst of a global economic downturn. The federal budget in January 2009, titled Canada's Economic Action Plan, was designed to respond to this downturn by stimulating the economy, in part by increasing government spending for sectors of the economy and regions of the country in need. The Economic Action Plan sought to stimulate spending by Canadians, stimulate housing construction, build infrastructure, and support businesses and communities. Together, these initiatives amounted to about $40 billion, with an additional $12 billion funded by the provinces and territories. These amounts were subsequently increased to about $47 billion in federal stimulus and $14 billion from provinces and territories. Budget 2009 also contained measures to add stability to the financial sector, which sought to improve access to financing for consumers and business by providing up to $200 billion in credit.

Over 35 federal entities worked to deliver close to 90 programs in support of the Economic Action Plan. In many cases, funding for existing programs was "topped up" with additional funds; other programs were modified to reflect the economic circumstances. Some programs were completely new. In most cases, funds were made available for a fixed two-year period. Any costs incurred beyond the deadline would not be funded by the federal government. Many of the programs were coordinated and delivered through provinces, territories, municipalities, third parties, non-governmental organizations, and the private sector; we did not audit their delivery of programs.

We audited the Economic Action Plan as it was being delivered. We looked at how programs were designed and delivered and what steps were taken to ensure that only eligible projects were funded. We selected 11 programs for examination and also looked at the role of internal audit. Our audit included the role played by central agencies—the Privy Council Office, the Treasury Board of Canada Secretariat, and the Department of Finance Canada. We also examined compliance with financial management and environmental requirements.

Audit work for this chapter was substantially completed on 27 April 2010. We plan to carry out a second audit that will focus on how the stimulus money was spent.

Why it's important

The global recession caused significant job losses in key sectors of the economy, such as the construction and forestry sectors. Expecting that the downturn could be temporary, the government proposed temporary, targeted programs designed to inject about $40 billion in stimulus spending into the Canadian economy, which was subsequently increased to about $47 billion. This represents about 2.9 percent of GDP.

An initiative as large and complex as the Economic Action Plan imposed a significant increase in workload on federal departments. As speed of delivery was of the essence, officials were under pressure to quickly design, deliver, monitor, and report on new or accelerated federal programs while continuing to deliver their existing programs. Together, these factors increased the risk that mistakes could be made. At the same time, there was concern that if the stimulus money were delayed or allocated too close to the end of the two-year time frame, it would not meet immediate, short-term needs.

What we found

- Central agencies and departments took steps to ensure that programs were designed and processes streamlined to allow individual projects to be selected and funds to be allocated quickly. For example, the Privy Council Office and Treasury Board of Canada Secretariat used an accelerated process to speed up the policy and financial approvals for many Economic Action Plan programs, such as the Knowledge Infrastructure Program. As a result, the total time needed to design, review, and approve programs was reduced from the approximately six months normally required to two months.
- All the projects we reviewed met the eligibility criteria as set out in the program terms and conditions. Important considerations for eligibility were that projects would start quickly and be substantially completed by 31 March 2011. However, we noted that some projects started late, and it is not clear whether they will be completed on time. In addition, decisions on whether an environmental assessment was required for some projects were made on the basis of insufficient information gathered from applicants. As a result, it is unclear whether some projects that were approved should have undergone an environmental assessment.

- Central agencies and departments all paid considerable attention to risk. Risks were assessed and controls and mitigation strategies were put in place. Capacity to deliver the Economic Action Plan within the short time frame was a significant risk facing departments, and senior management implemented additional controls to manage this risk. In addition, the Office of the Comptroller General of Canada worked closely with departmental internal audit groups to help address risks. Departmental internal audit groups adjusted their audit plans to focus on areas of greater risk and provided appropriate advice and assurance to management.
- The government met the requirement to provide Parliament with quarterly progress reports on the implementation of the Economic Action Plan. However, the project-level information on jobs included in the quarterly reports was largely anecdotal and did not present a complete picture of all jobs created, nor did it include information on jobs created or maintained for all Economic Action Plan programs. Because of these data limitations, the government reported a macroeconomic estimate of jobs created or maintained as of January 2010. The total number of jobs created or maintained under the Economic Action Plan remains to be fully measured. The Department of Finance Canada has indicated this will be done through a macroeconomic estimate once the Plan is completed.

The entities have responded. The entities have agreed or generally agreed with our recommendations. Their detailed responses follow the recommendations throughout the chapter, as applicable.



Management and Control in Small Entities

Chapter 2 Main Points

What we examined

The federal government includes a large number of small agencies, boards, and commissions that carry out a wide range of activities, from environmental assessment to transportation safety. Most of these organizations, generally known as "small entities," have investigatory, regulatory, or quasi-judicial functions. For this audit of management and control practices, we considered small entities to be federal organizations that either have operating budgets of less than $300 million a year or have fewer than 500 employees.

Our audit examined three small entities:

- The Canadian Forces Housing Agency, a special operating agency within National Defence. It operates, maintains, and allocates roughly 14,000 housing units across Canada on the Department's behalf.
- The Canadian Pari-Mutuel Agency, a special operating agency within Agriculture and Agri-Food Canada. The Agency regulates and supervises pari-mutuel betting on horse races to ensure that betting is fair to the public.
- The Pension Appeals Board, an administrative tribunal that is responsible for hearing appeals of Canada Pension Plan applicants that arise from decisions of the Office of the Commissioner of Review Tribunals. Although the Board is an administrative part of Human Resources and Skills Development Canada, it is independent of that department in its quasi-judicial role.

We looked at the controls applied by the three entities for acquisition cards, contracting, executive travel, hospitality, and selected areas of human resource management. We also examined whether the entities' management and control practices comply with government policies.

Audit work for this chapter was substantially completed on 16 March 2010.

This was the third audit of small entities reported by this Office; our previous audits looked at management and control, and at governance arrangements.

Why it's important

The relatively small federal organizations defined as small entities can have a significant impact on the health, safety, and quality of life of Canadians; on recourse for public servants or for citizens in cases of perceived unfairness and inequity; and on the competitiveness of Canadian industry. Some settle claims or arbitrate disputes that involve the government as an interested party, and they must therefore be independent from the government in such matters. As publicly funded bodies within the government, they need to ensure prudence, probity, and effective control over the spending of public funds.

What we found

- All three entities have management controls in place that are consistent with Treasury Board requirements and that are applied in managing the use of acquisition cards, contracting, executive travel, and hospitality.
- The Canadian Forces Housing Agency and the Pension Appeals Board have well defined human resource plans that are based on their operational needs. These plans identify future needs and challenges and are supported by strategies and initiatives. At the time of our audit, the Canadian Pari-Mutuel Agency was working on a draft human resource plan that had yet to be approved.
- All three entities have performance management systems in place and manage executive compensation in compliance with relevant authorities, although documentation of performance agreements and appraisals could be improved.

The entities have responded. The entities agree with the recommendation. Their detailed responses follow the recommendation in the chapter.



Service Delivery

Chapter 3 Main Points

What we examined

The federal government delivers a broad range of services that affect the well-being of individuals and organizations across the country and abroad. Deputy heads of federal organizations are responsible for managing the delivery of these services in accordance with their organizations' objectives, guidelines, and procedures.

We looked at the practices used by three organizations—Citizenship and Immigration Canada, Human Resources and Skills Development Canada, and the Canada Revenue Agency—to set their service standards, monitor and report on their service performance, and act on this information to improve service quality.

Audit work for this chapter was substantially completed on 31 March 2010.

Why it's important

The federal government delivers many services directly to millions of individuals, ranging from issuing passports to answering tax inquiries, to processing claims for Employment Insurance. All Canadians require the services of the federal government at one time or another, and research indicates that they expect high-quality service. At the same time, the government must balance clients' service needs with policy requirements and available resources.

What we found

- Citizenship and Immigration Canada has been working to develop service standards since 2007. It has so far established a limited number of standards, and these do not cover some of its major programs. Therefore, the Department cannot fully measure and report on its service performance. Nevertheless, it has some processes already in place that could form the basis for more comprehensive monitoring of service quality. The Department has taken action to better manage the quality of its service delivery, in line with its strategic priority of improving its service to clients.
- Human Resources and Skills Development Canada has client-oriented standards covering its main services. It uses these service standards to monitor and report on its performance. Through ongoing monitoring of performance against these service standards

and through collecting feedback from its clients, the Department has identified issues and taken action in several areas to improve service.

- The Canada Revenue Agency has set service standards for services it has determined are important to its clients and has well-established processes for assessing its clients' needs and expectations: Many transactions that were once largely paper-based are now offered by telephone and on the Internet. While service standards have been added and updated, some may not reflect clients' current priorities. The Agency is in the process of reviewing and updating its service standards, which will provide it with an opportunity to ensure that its standards reflect current client and operational needs.

The organizations have responded. The organizations agree with our observations. Citizenship and Immigration Canada's response follows the recommendation in the chapter.



Managing Conflict of Interest

Chapter 4 Main Points

What we examined

In the federal government, "conflict of interest" refers to a conflict arising between the public service duties of public servants and their private interests. Outside parties—consultants or contractors—may also have conflicts of interest in carrying out work for the federal government. At the time of our audit, the Values and Ethics Code for the Public Service, published in June 2003, was the government's main policy for conflict of interest as it applies to public servants.

We looked at what the Treasury Board of Canada Secretariat and five selected departments have done to ensure that public servants can recognize a conflict of interest, however it arises, and know how to deal with it. We had found cases of conflict of interest in previous audits in three of the departments: Agriculture and Agri-Food Canada, Natural Resources Canada, and Public Works and Government Services Canada. We included those departments as well as Canadian Heritage and Human Resources and Skills Development Canada in this audit.

Audit work for this chapter was substantially completed on 31 May 2010.

Why it's important

Conflict of interest is a government-wide issue that can extend across the public service to any department or agency. The public's trust in government institutions is fundamental to the work of Canada's public service. Whether apparent, potential, or real, conflicts of interest bring into question the integrity and fairness of decisions made by public servants. If not properly addressed, conflicts of interest can increase the level of distrust and cynicism toward government and, over time, impact the legitimacy and effectiveness of government actions.

What we found

- The Treasury Board of Canada Secretariat plays an important role, but is not providing sustained support to departments. Two areas that have suffered are policy guidance and training with content from the policy centre. This training supports departments and agencies in meeting common needs for training related to conflict of interest. The requirement to put in place new policies was also not met. As the responsible central agency, the Secretariat's role is

crucial in fostering a shared understanding of the rules that govern conflict of interest throughout the public service.

- The five departments we examined have put in place mechanisms and assistance to address conflict of interest and, overall, have met their obligations under the Values and Ethics Code. Departments have set up organizational units to deal with values and ethics, designated senior officials to help public servants resolve issues related to the application of the code, and provided guidance and training on conflict of interest. For example, departments use their intranet sites to inform public servants about conflict of interest and provide contact information for staff who can answer questions.
- The departments have put in place processes to analyze conflict of interest declarations and identify and assess potential issues, but they need to follow up on required action and make sure that declarations are dealt with in a timely manner. Where it was clear that there was no conflict of interest, files were processed quickly, but our file review found that in 11 cases out of 25, processing took more than 120 days. Without adequate and timely follow-up, management cannot be assured that measures have been taken to mitigate or eliminate conflicts of interest.
- The three departments where previous audits found cases of conflict of interest have taken steps to address the risks identified. However, at the time of our audit, none of the departments had reviewed all areas of its organization to identify risks of conflict of interest. When departments know where conflict of interest is likely to occur, they can help staff guard against this risk, for example, through training to help public servants understand the situations they could face and the best way to address them.

The Treasury Board of Canada Secretariat and the departments have responded. The Secretariat and the departments agree with our recommendations. Their detailed responses follow each recommendation throughout the report.



Regulating and Supervising Large Banks

Chapter 5 Main Points

What we examined

In Canada, banks are regulated and supervised by a number of federal organizations responsible for contributing to the stability and efficiency of the financial system. The Department of Finance Canada provides policy advice on the legislation that governs banks and their regulation. The Office of the Superintendent of Financial Institutions Canada supervises banks by assessing their financial condition and verifying their compliance with the laws and regulations that govern them. The Canada Deposit Insurance Corporation provides deposit insurance and has some responsibility over managing risks posed by banks as well as in the monitoring and resolution of failing banks. The Bank of Canada has a role in providing lender of last resort facilities as well as in overseeing clearing and settlement systems.

We examined how the Department of Finance Canada and the Office of the Superintendent of Financial Institutions Canada have regulated and supervised the six largest banks in Canada, which are considered the most important to the Canadian financial system. We also examined how the Department of Finance Canada, the Office of the Superintendent of Financial Institutions Canada, and the Canada Deposit Insurance Corporation shared information for decision making. In addition, we examined how the federal organizations request information from banks.

Audit work for this chapter was substantially completed on 31 March 2010.

Why it's important

Instability in Canada's financial system can cause the public to lose confidence in banks and fear for their savings. It can also have significant fiscal consequences if the government has to step in and provide financial assistance to a bank that is in danger of failing. Banks play key functions in just about every economic exchange that takes place in the economy and are key sources of financing. Therefore, a sound and stable banking system is essential for Canada's economic well-being.

Compared with many other countries, Canadian banks fared well during the recent global financial crisis. Experts have attributed this in part to Canada's approach to regulating and supervising its banks. However, the recent crisis also caused the global financial environment to change at an ever-increasing pace, with international agreements and commitments producing a more complex regulatory framework. In addition, the financial industry continues to develop more diverse and complex financial models and products, which have higher risks. The stability of the banking system could be impacted if Canada's regulatory framework and supervisory approach do not keep pace with these developments.

What we found

- The Department of Finance Canada, the Office of the Superintendent of Financial Institutions Canada, and the Canada Deposit Insurance Corporation regularly share relevant information on regulating and supervising banks. This ongoing exchange of information contributed to Canada's relative success in responding to the recent global financial turmoil as the federal organizations had relevant and up-to-date information for decision making. The Office of the Superintendent of Financial Institutions Canada also interacted appropriately with foreign supervisors and regulators by exchanging information on cross-border issues. These exchanges help Canada stay abreast of emerging issues.

- The federal regulatory framework for banks is kept up to date to reflect emerging domestic and international developments. The legislation governing Canada's banks, the *Bank Act*, is revised every five years following broad consultation. However, there is no process to perform periodic reviews of the effectiveness of the significant parts of the regulatory and legislative framework to determine whether the existing rules and policies support a stable and efficient financial system. Without this type of effectiveness review, it is difficult for the government to determine whether successive regulatory changes are working or have had negative unintended consequences.

- The Office of the Superintendent of Financial Institutions Canada adequately supervises Canada's six largest banks and monitors emerging risks. However, the growing volume and complexity of its work is increasing the demands on its human resources. This challenge, combined with pressures on training and compensation, could affect the Office's ability to attract and retain qualified staff to maintain its capacity and competency to carry out its supervisory mandate.

- Together the Department of Finance Canada, the Office of the Superintendent of Financial Institutions Canada, and the Canada Deposit Insurance Corporation are increasingly asking banks for more information, but they are not periodically assessing whether they need all of this information to fulfill their regulatory and supervisory responsibilities. It is challenging for these entities to precisely determine the amount and type of information required. Although efforts are under way to improve the collection of information, progress on assessing the adequacy of information requested from banks has been limited.

The entities have responded. The entities agree with all of our recommendations. Their detailed responses follow the recommendations throughout the chapter.



Acquisition of Military Helicopters

Chapter 6 Main Points

What we examined

National Defence is replacing and upgrading its helicopter fleet and will spend nearly $11 billion to acquire two new types of helicopters along with long-term in-service support. The CH-148 Cyclone is a maritime helicopter that will replace the Sea King helicopters; and the CH-147 Chinook is a medium- to heavy-lift helicopter. These modern and technologically sophisticated helicopters are expected to bring new and enhanced capabilities to the Canadian Forces.

Although there are significant differences between the two acquisition projects, both have experienced cost increases and significant schedule delays. For both projects, National Defence has adopted a relatively new approach to providing for long-term in-service support.

We examined how National Defence managed the acquisitions, with emphasis on whether the work to be carried out was described clearly and consistently in key information and decision documents, risks were appropriately assessed and managed, life-cycle costs and plans were complete and timely, and senior departmental boards provided appropriate oversight and approvals. We also examined the contract award process for the projects by National Defence and Public Works and Government Services Canada.

Our conclusions relate only to the management practices and actions of public servants. We did not audit the records of the private sector contractors and, consequently, our conclusions cannot and do not pertain to the contractor's practices or to their performance.

Our access to Cabinet confidences created prior to 2006 is governed by a 1985 order-in-council that permits access only to certain types of Cabinet confidences. Accordingly, we were not provided with information regarding decisions that were made prior to 2006.

Audit work for this chapter was substantially completed on 30 April 2010.

Why it's important

The capabilities that National Defence is seeking to obtain in acquiring the Cyclone and the Chinook helicopters are considered by the Department as essential to the support of Canada's military operations internationally and at home.

The total project cost of 28 Cyclone helicopters, together with initial set-up, training, provision of spare parts and long-term maintenance, is now estimated at $5.7 billion. Delivery of the first fully capable Cyclone, initially expected in 2005, was delayed to 2008 and is now expected to occur in 2012. The total project cost of 15 Chinook helicopters, together with initial set-up, training, and long-term maintenance, is now estimated at more than $4.9 billion. The first fully capable helicopter is scheduled for delivery in 2013, five years later than planned.

Given the cost and complexity of military acquisitions, how they are managed is subject to a number of regulations, policies, and controls designed to ensure that the equipment and services acquired meet the identified needs and are delivered on time and within budget in a way that enhances access, competition, and fairness. Careful planning and full costing of these projects are needed to ensure that all project elements come together in a timely and predictable way and that adequate funds are available over the long term. The demanding acquisition process requires effective leadership, oversight, and due diligence by senior decision makers across several departments. We recognize the significant efforts of many individuals involved in these projects over many years.

What we found

- National Defence underestimated and understated the complexity and developmental nature of the helicopters that it intended to buy. Both helicopters were described to internal decision makers and the Treasury Board as non-developmental, using "off the shelf" technologies. On that basis, overall project risks were assessed as low to medium. In each case, however, significant modifications were made to the basic models. For the maritime helicopter, this will result in an aircraft that never existed before. For the medium- to heavy-lift helicopter, this will result in a new variant of the Chinook. Ultimately, these modifications led to schedule delays and cost increases beyond original plans.
- The medium- to heavy-lift helicopter acquisition was a directed procurement using an advance contract award notice (ACAN). National Defence had initially planned to proceed rapidly to contract award by spring 2007; however, its needs and priorities were not precisely defined at the outset, evolved over the course of the acquisition, and were not finalized until 2009. The manner in which

Public Works and Government Services Canada used the ACAN did not comply with the letter or intent of the applicable regulations and policies and, consequently, the contract award process was not fair, open, and transparent.

- National Defence did not develop full life-cycle plans and costs for these helicopters in a complete or timely way. In addition, total estimated costs were not disclosed to decision makers at key decision points. Some costs have yet to be completely estimated and some elements needed for the capability are not in place. Without adequate cost information, National Defence cannot plan to have sufficient funds available for long-term operation and support of the helicopters. Moreover, without sufficient funds, National Defence may have to curtail planned training and operations.
- National Defence did not fully comply with the oversight and approval framework established in its Project Approval Guide. For the maritime helicopter project, boards provided appropriate oversight at the preliminary project and effective project approval stages. However, neither the Senior Review Board nor the Program Management Board met to challenge and approve the information in the 2008 revised effective project approval that was related to the contract amendment approval of $262 million. For the medium- to heavy-lift helicopter, there was an absence of timely meetings, challenge, and approvals by senior boards at all key decision points in the acquisition process and before seeking Treasury Board approvals.

The entities have responded. The entities agree with all of our recommendations. Their detailed responses follow the recommendations throughout the chapter.



Registered Charities—Canada Revenue Agency

Chapter 7 Main Points

What we examined

There are more than 85,000 registered charities in Canada. They are exempt from paying tax on their income, and the federal government allows taxpayers to claim a tax deduction or a tax credit for charitable donations to reduce the income tax that they pay. For 2009, the estimated cost to the federal government of providing tax relief to individuals for charitable donations was almost $2.4 billion.

The Canada Revenue Agency administers the *Income Tax Act*, including the provisions that relate to registered charities. To fulfil its role with respect to registered charities, the Agency defines its responsibilities as processing applications for registered charity status, carrying out audit and compliance activities, offering advice and guidance on complying with requirements of the Act, and providing general information to the public.

We examined how the Agency encourages compliance with the provisions of the *Income Tax Act* that relate to registered charities. We also looked at how the Agency deals with tax shelter gifting arrangements. These arrangements typically promise taxpayers (or "participants") that they can buy property, donate it, and receive a donation tax credit that is worth more than the amount they originally spent to purchase the donated property. Promoters of tax shelters are required to obtain an identification number from the Agency before they can sell, issue, or accept consideration from participants.

Audit work for this chapter was substantially completed on 8 June 2010.

Why it's important

To many Canadians, charities play an important role in society. They provide services that people might otherwise expect the government to provide. Canadians can volunteer for causes important to them, or make donations to those charities that they want to support.

The Agency's role is to ensure that charities comply with the measures in the *Income Tax Act*, so that their activities will achieve the charitable purposes for which they have been created.

As part of its role in protecting taxpayers by preventing abuses, the Agency has announced that it is reviewing all tax shelter-related gifting arrangements. It plans to audit every participating charity, promoter, and participant and has issued a number of news releases warning taxpayers about the arrangements. Tens of thousands of taxpayers have invested in these arrangements. Although very few registered charities are involved with tax shelter gifting arrangements, their actions could impact the whole charitable sector and cause some donors to stop making donations to those charities that are not involved in abusive tax shelters.

What we found

- The Agency's process for registering charities is thorough. The controls in place are adequate to monitor and manage the process for approving an organization's application for registered charity status. This process is important because it may be the most in-depth involvement the Agency has with a charity during its life cycle.
- More than 33,000 charities did not file their annual information returns on time in 2008. The Agency posts certain information from these returns on its public website. Donors can visit the Agency's website to check that a charity is registered and see select operating and board member information. Agency policy for dealing with charities that file their annual returns late is to issue reminder letters and de-register the charity after 10 months. Between 2007 and 2009, over 3,000 charities had their registration revoked for failure to file their returns. Most charities did file their returns once they received reminders.
- The Agency carries out random and risk-based audits to verify that registered charities remain in compliance with the *Income Tax Act*. In cases of non-compliance, the Agency has a range of tools and sanctions it can apply, ranging from education letters and negotiated agreements to intermediate and serious sanctions. However, although it has guidelines and references to sanctions in its audit manuals, it lacks sufficiently detailed internal guidance. During the period under audit, it continued to use mostly education letters, compliance agreements, and revocations; two charities were assessed intermediate sanctions.
- The Agency's communication to charities and donors is good, with information accessible through several channels, such as on the Agency website; by telephone, webcasts, and outreach programs; and on paper. For example, users can use the Internet, mail, or telephone to check whether a charity is currently registered, under suspension from issuing tax receipts, or has had its charitable status

revoked. The Agency also has processes to ensure that the information it adds to its website is accurate and feedback mechanisms to verify that users' information needs are being met.

- The Agency has expressed concerns with some tax shelter gifting arrangements and has issued general warnings about them. The number of active tax shelter gifting arrangements is declining, but people continue to invest in them, a total of 172,300 by 31 December 2009. The Agency has audited many of them and by 31 March 2009, it had reassessed the amount of charitable donations claimed by over 69,000 participants who had invested in these arrangements.

The Agency has responded. The Agency agrees with all of our recommendations. Its detailed responses follow the recommendations throughout the chapter.



Facilitating the Flow of Imported Commercial Goods—Canada Border Services Agency

Chapter 8 Main Points

What we examined

The Canada Border Services Agency is the lead federal agency for operations at border ports of entry. Under the *Canada Border Services Agency Act*, the Agency has a dual mandate to provide integrated border services that support national security and public safety priorities and that facilitate the free flow of persons and goods that meet all regulatory requirements. The Agency works with other partners to provide these services.

We examined how the Agency fulfills the second part of its mandate, which is to provide integrated border services that facilitate the free flow of imported commercial goods and collect the revenues owed. The Agency has interpreted facilitation to mean minimizing administrative costs, minimizing intervention in the movement of goods, and minimizing delays, to the greatest possible extent while managing risks and ensuring compliance with regulatory requirements.

We examined the Agency's systems and practices for collecting and processing information to assess risk before goods arrive at the border, providing examination facilities and ensuring that they are adequate, developing service standards and monitoring performance against them, and assessing and collecting duties and taxes. We did not examine the Agency's responsibilities and activities related to unlawful or non-commercial goods being imported or exported; commercial goods being imported or exported by post; goods in transit or temporary admission of vessels for coastal trade; or the entry, detention, or removal of travellers.

Audit work for this chapter was substantially completed on 31 May 2010.

Why it's important

In the 2008–09 fiscal year, the Agency provided commercial services for 217,000 importers, 3,000 carriers, and 250 licensed brokers. It processed about 12 million commercial import transactions and more than 29 million low-value courier import transactions, many of which were also commercial goods. The Agency is the government's second

largest tax collector. It reported collecting $23 billion in import tax revenues in 2008–09, almost all of which was from commercial goods.

Canada imports large volumes of goods every year. From 2005 to 2008, Canadian imports of goods rose from $388 billion to $443 billion. The Organization for Economic Co-operation and Development reported that about 28 percent of the goods consumed by Canadians in 2008 were provided by imports. Imports are also critical components of many Canadian exports.

The process of importing goods adds to importers' costs, including those associated with transportation, required examinations, and providing information to government organizations. Canadians benefit when these costs are minimized, because any increases can weaken the competitive position of Canadian industries, and because cost increases may also be passed on to the consumer. Members of the trade community have indicated that they want the Agency to deliver border services in an open and transparent manner so that the commercial importing process is more predictable and consistent.

What we found

- The Agency's systems and practices facilitate the flow of imported commercial goods. However, there are still some limitations that lead to inconsistent levels of facilitation, depending on where and when the goods enter the country. The Agency has undertaken two initiatives—the eManifest project and the Single Window Initiative—to align its operations with the best-case scenario of moving low-risk shipments through the border with minimal intervention. These initiatives aim to further automate and integrate the information the Agency requires from importers to assess risk.
- The Agency does not have reasonable assurance that the information provided electronically by commercial clients at various stages of the importing process is accurate, complete, and timely. Its monitoring process is unsystematic and limited in scope, which has an impact on the Agency's ability to effectively assess risk. The Agency has recognized this gap and has plans designed to provide it with better information about the extent to which the data it receives is accurate, complete, and timely.
- The Agency has established service standards for many of its key services to importers, such as processing times for electronic information and wait times at land border crossings. However, some of these standards cannot be measured accurately and the results are published only for land border wait times. Without better published information, the importing process is less predictable and it is difficult for importers to make informed business decisions about

how, when, and where to import goods. The Agency has begun to develop a service strategy to address these issues.

- The Agency does not have reasonable assurance that commercial clients' assessments of duties and taxes owed are based on accurate information. Without such assurance, the Agency cannot verify that assessments are correct and that it is collecting the correct revenues owed. It also risks providing other government organizations, such as Statistics Canada and the Department of Finance Canada, with inaccurate and incomplete trade and revenue information. The Agency has recognized this gap and is working on a strategy to address it.

The Agency has responded. The Agency agrees with all of our recommendations. Its detailed responses follow the recommendations throughout the chapter.



Animal Diseases—Canadian Food Inspection Agency

Chapter 9 Main Points

What we examined

The Canadian Food Inspection Agency monitors the international progression of animal diseases, controls animal imports, and responds to animal diseases when they are detected in Canada. Working with industry, the provinces, and other federal departments, the Agency delivers a number of programs and services designed to protect Canada's animal resource base. About $200 million annually—30 percent of its budget—is allocated to animal health programs.

Among these animal health programs, we examined the Agency's state of preparedness for animal disease emergencies—situations that call for prompt action outside of normal activities. We also looked at how the Agency managed recent animal disease emergencies.

Audit work for this chapter was substantially completed on 30 April 2010.

Why it's important

Trends in animal disease indicate that new diseases are emerging and more virulent forms of existing diseases, such as tuberculosis, are on the increase. Certain animal diseases, such as avian influenza, also threaten human health. Foreign animal diseases are of particular concern as many such diseases could enter Canada because of international trade and travel.

Failure to prevent the spread of animal diseases, including those that can be spread to humans, could cost Canada's livestock industry billions of dollars in lost production, the loss of international markets through export embargoes, and the costs of control and response activities.

What we found

- The Agency has developed a collection of documents to guide its response to animal disease emergencies. These include its overall emergency response plan, the animal health functional plan that provides a framework for responding to animal diseases, and hazard-specific plans for avian influenza and foot-and-mouth disease. These plans are consistent with accepted emergency management standards.

- Some important work to improve readiness is not assigned deadlines or tracked until complete. The Agency has identified the need to update disease specific plans and develop procedures for certain higher risk animal diseases. However, it has not identified priorities or established a work plan to complete this work. This means that important work may not be completed on a timely basis, which could impact the Agency's emergency readiness. While the Agency has invested considerable effort in developing emergency preparedness and response strategies, key challenges remain. For example, the Agency has significant work to do to enhance readiness for foot-and-mouth disease.
- The Agency has a wide range of activities to enable it to derive lessons from animal disease emergencies and training exercises. However, it lacks a systematic approach to ensure that all key lessons are compiled, tracked, and acted upon. As a result, similar issues continue to be identified over the years. If these issues are not addressed, the Agency's response to an emergency could be affected.
- The Agency followed its established plans and procedures in managing the response to the avian influenza outbreaks of 2007 in Saskatchewan and 2009 in British Columbia. However, each disease and each outbreak is unique, and these results cannot be generalized to predict the Agency's response to future outbreaks.

The Agency has responded. The Agency agrees with all of the recommendations. Its detailed responses follow the recommendations throughout the chapter.

Appendices

Appendix A *Auditor General Act*

An Act respecting the Office of the Auditor General of Canada and sustainable development monitoring and reporting

Short Title

Short title

1. This Act may be cited as the *Auditor General Act*.

Interpretation

Definitions

2. In this Act,

"appropriate Minister" "appropriate Minister" has the meaning assigned by section 2 of the *Financial Administration Act*;

"Auditor General" "Auditor General" means the Auditor General of Canada appointed pursuant to subsection 3(1);

"category I department" "category I department" means

(a) any department named in schedule I to the *Financial Administration Act*,

(b) any department in respect of which a direction has been made under subsection 11(3) of the *Federal Sustainable Development Act*; and

(c) any agency set out in the schedule to the *Federal Sustainable Development Act*.

"Commissioner" "Commissioner" means the Commissioner of the Environment and Sustainable Development appointed under subsection 15.1(1);

"Crown corporation" "Crown corporation" has the meaning assigned to that expression by section 83 of the *Financial Administration Act*;

"department" "department" has the meaning assigned to that term by section 2 of the *Financial Administration Act*;

"funding agreement" "funding agreement" has the meaning given to that expression by subsection 42(4) of the *Financial Administration Act*;

"recipient" "recipient" has the meaning given to that expression by subsection 42(4) of the *Financial Administration Act*;

"registrar" "registrar" means the Bank of Canada and a registrar appointed under Part IV of the *Financial Administration Act*;

"sustainable development" means development that meets the needs of the present without compromising the ability of future generations to meet their own needs;

Control

2.1 (1) For the purpose of paragraph (d) of the definition "recipient" in subsection 42(4) of the *Financial Administration Act*, a municipality or government controls a corporation with share capital if

(a) shares of the corporation to which are attached more than fifty per cent of the votes that may be cast to elect directors of the corporation are held, otherwise than by way of security only, by, on behalf of or in trust for that municipality or government; and

(b) the votes attached to those shares are sufficient, if exercised, to elect a majority of the directors of the corporation.

Control

(2) For the purpose of paragraph (d) of the definition "recipient" in subsection 42(4) of the *Financial Administration Act*, a corporation without share capital is controlled by a municipality or government if it is able to appoint the majority of the directors of the corporation, whether or not it does so.

Auditor General of Canada

Appointment

3. (1) The Governor in Council shall, by commission under the Great Seal, appoint an Auditor General of Canada after consultation with the leader of every recognized party in the Senate and House of Commons and approval of the appointment by resolution of the Senate and House of Commons.

Tenure

(1.1) The Auditor General holds office during good behaviour for a term of 10 years but may be removed for cause by the Governor in Council on address of the Senate and House of Commons.

Ceasing to hold office

(2) Despite subsections (1) and (1.1), the Auditor General ceases to hold office on reaching 65 years of age.

Re-appointment

(3) Once having served as the Auditor General, a person is not eligible for re-appointment to that office.

Interim appointment

(4) In the event of the absence or incapacity of the Auditor General or if that office is vacant, the Governor in Council may appoint any qualified auditor to hold that office in the interim for a term not exceeding six months, and that person shall, while holding office, be paid the salary or other remuneration and expenses that may be fixed by the Governor in Council.

Salary

4. (1) The Auditor General shall be paid a salary equal to the salary of a puisne judge of the Supreme Court of Canada.

Pension benefits

(2) The provisions of the *Public Service Superannuation Act*, other than those relating to tenure of office, apply to the Auditor General except that a person appointed as Auditor General from outside the public service may, by notice in writing given to the President of the Treasury Board not more than sixty days after the date of his appointment as Auditor General, elect to participate in the pension plan provided for in the *Diplomatic Service (Special) Superannuation Act* in which case the provisions of that Act, other than those relating to tenure of office, apply to him and the provisions of the *Public Service Superannuation Act* do not apply to him.

Powers and Duties

Examination

5. The Auditor General is the auditor of the accounts of Canada, including those relating to the Consolidated Revenue Fund and as such shall make such examinations and inquiries as he considers necessary to enable him to report as required by this Act.

Idem

6. The Auditor General shall examine the several financial statements required by section 64 of the *Financial Administration Act* to be included in the Public Accounts, and any other statement that the President of the Treasury Board or the Minister of Finance may present for audit and shall express his opinion as to whether they present fairly information in accordance with stated accounting policies of the federal government and on a basis consistent with that of the preceding year together with any reservations he may have.

Annual and additional reports to the House of Commons

7. (1) The Auditor General shall report annually to the House of Commons and may make, in addition to any special report made under subsection 8(1) or 19(2) and the Commissioner's report under subsection 23(2), not more than three additional reports in any year to the House of Commons

(a) on the work of his office; and,

(b) on whether, in carrying on the work of his office, he received all the information and explanations he required.

Idem

(2) Each report of the Auditor General under subsection (1) shall call attention to anything that he considers to be of significance and of a nature that should be brought to the attention of the House of Commons, including any cases in which he has observed that

(a) accounts have not been faithfully and properly maintained or public money has not been fully accounted for or paid, where so required by law, into the Consolidated Revenue Fund;

(b) essential records have not been maintained or the rules and procedures applied have been insufficient to safeguard and control public property, to secure an effective check on the assessment, collection and proper allocation of the revenue and to ensure that expenditures have been made only as authorized;

(c) money has been expended other than for purposes for which it was appropriated by Parliament;

(d) money has been expended without due regard to economy or efficiency;

(e) satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented; or

(f) money has been expended without due regard to the environmental effects of those expenditures in the context of sustainable development.

Submission of annual report to Speaker and tabling in the House of Commons

(3) Each annual report by the Auditor General to the House of Commons shall be submitted to the Speaker of the House of Commons on or before December 31 in the year to which the report relates and the Speaker of the House of Commons shall lay each such report before the House of Commons forthwith after receiving it or, if that House is not then sitting, on any of the first fifteen days on which that House is sitting after the Speaker receives it.

Notice of additional reports to Speaker and tabling in the House of Commons

(4) Where the Auditor General proposes to make an additional report under subsection (1), the Auditor General shall send written notice to the Speaker of the House of Commons of the subject-matter of the proposed report.

Submission of additional reports to Speaker and tabling in the House of Commons

(5) Each additional report of the Auditor General to the House of Commons made under subsection (1) shall be submitted to the House of Commons on the expiration of thirty days after the notice is sent pursuant to subsection (4) or any longer period that is specified in the notice and the Speaker of the House of Commons shall lay each such report before the House of Commons forthwith after receiving it or, if that House is not then sitting, on any of the first fifteen days on which that House is sitting after the Speaker receives it.

Inquiry and report

7.1 (1) The Auditor General may, with respect to a recipient under any funding agreement, inquire into whether

(a) the recipient has failed to fulfil its obligations under any funding agreement;

(b) money the recipient has received under any funding agreement has been used without due regard to economy and efficiency;

(c) the recipient has failed to establish satisfactory procedures to measure and report on the effectiveness of its activities in relation to the objectives for which it received funding under any funding agreement;

(d) the recipient has failed to faithfully and properly maintain accounts and essential records in relation to any amount it has received under any funding agreement; or

(e) money the recipient has received under any funding agreement has been expended without due regard to the environmental effects of those expenditures in the context of sustainable development.

Report

(2) The Auditor General may set out his or her conclusions in respect of an inquiry into any matter referred to in subsection (1) in the annual report, or in any of the three additional reports, referred to in subsection 7(1). The Auditor General may also set out in that report anything emerging from the inquiry that he or she considers to be of significance and of a nature that should be brought to the attention of the House of Commons.

Special report to the House of Commons

8. (1) The Auditor General may make a special report to the House of Commons on any matter of pressing importance or urgency that, in the opinion of the Auditor General, should not be deferred until the presentation of the next report under subsection 7(1).

Submission of reports to Speaker and tabling in the House of Commons

(2) Each special report of the Auditor General to the House of Commons made under subsection (1) or 19(2) shall be submitted to the Speaker of the House of Commons and shall be laid before the House of Commons by the Speaker of the House of Commons forthwith after receipt thereof by him, or if that House is not then sitting, on the first day next thereafter that the House of Commons is sitting.

Idem

9. The Auditor General shall

(a) make such examination of the accounts and records of each registrar as he deems necessary, and such other examinations of a registrar's transactions as the Minister of Finance may require, and

(b) when and to the extent required by the Minister of Finance, participate in the destruction of any redeemed or cancelled securities or unissued reserves of securities authorized to be destroyed under the *Financial Administration Act*,

and he may, by arrangement with a registrar, maintain custody and control, jointly with that registrar, of cancelled and unissued securities.

Improper retention of public money

10. Whenever it appears to the Auditor General that any public money has been improperly retained by any person, he shall forthwith report the circumstances of the case to the President of the Treasury Board.

Inquiry and report

11. The Auditor General may, if in his opinion such an assignment does not interfere with his primary responsibilities, whenever the Governor in Council so requests, inquire into and report on any matter relating to the financial affairs of Canada or to public property or inquire into and report on any person or organization that has received financial aid from the Government of Canada or in respect of which financial aid from the Government of Canada is sought.

Advisory powers

12. The Auditor General may advise appropriate officers and employees in the federal public administration of matters discovered in his examinations and, in particular, may draw any such matter to the attention of officers and employees engaged in the conduct of the business of the Treasury Board.

Access to Information

Access to information

13. (1) Except as provided by any other Act of Parliament that expressly refers to this subsection, the Auditor General is entitled to free access at all convenient times to information that relates to the fulfilment of his or her responsibilities and he or she is also entitled to require and receive from members of the federal public administration such information, reports and explanations as he or she considers necessary for that purpose.

Stationing of officers in departments

(2) In order to carry out his duties more effectively, the Auditor General may station in any department any person employed in his office, and the department shall provide the necessary office accommodation for any person so stationed.

Oath of secrecy

(3) The Auditor General shall require every person employed in his office who is to examine the accounts of a department or of a Crown corporation pursuant to this Act to comply with any security requirements applicable to, and to take any oath of secrecy required to be taken by, persons employed in that department or Crown corporation.

Inquiries

(4) The Auditor General may examine any person on oath on any matter pertaining to any account subject to audit by him and for the purposes of any such examination the Auditor General may exercise all the powers of a commissioner under Part I of the *Inquiries Act*.

Reliance on audit reports of Crown corporations

14. (1) Notwithstanding subsections (2) and (3), in order to fulfil his responsibilities as the auditor of the accounts of Canada, the Auditor General may rely on the report of the duly appointed auditor of a Crown corporation or of any subsidiary of a Crown corporation.

Auditor General may request information

(2) The Auditor General may request a Crown corporation to obtain and furnish him such information and explanations from its present or former directors, officers, employees, agents and auditors or those of any of its subsidiaries as are, in his opinion, necessary to enable him to fulfil his responsibilities as the auditor of the accounts of Canada.

Direction of the Governor in Council

(3) If, in the opinion of the Auditor General, a Crown corporation, in response to a request made under subsection (2), fails to provide any or sufficient information or explanations, he may so advise the Governor in Council, who may thereupon direct the officers of the corporation to furnish the Auditor General with such information and explanations and to give him access to those records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries access to which is, in the opinion of the Auditor General, necessary for him to fulfil his responsibilities as the auditor of the accounts of Canada.

Staff of the Auditor General

Officers, etc.

15. (1) The officers and employees that are necessary to enable the Auditor General to perform his or her duties are to be appointed in accordance with the *Public Service Employment Act* and, subject to subsections (2) to (5), the provisions of that Act apply to those officers and employees.

Public Service Employment Act —employer and deputy head

(2) The Auditor General may exercise the powers and perform the functions of the employer and deputy head under the *Public Service Employment Act* within the meaning of those terms in subsection 2(1) of that Act.

Public Service Employment Act —Commission

(3) The Auditor General may, in the manner and subject to the terms and conditions that the Public Service Commission directs, exercise the powers and perform the functions of that Commission under the *Public Service Employment Act*, other than its powers and functions in relation to the hearing of allegations by a candidate under sections 118 and 119 of that Act and its power to make regulations.

Delegation

(4) The Auditor General may authorize any person employed in his or her office to exercise and perform, in any manner and subject to any terms and conditions that he or she directs, any of his or her powers and functions under subsections (2) and (3).

Sub-delegation

(5) Any person authorized under subsection (4) may, subject to and in accordance with the authorization, authorize one or more persons under that person's jurisdiction to exercise any power or perform any function to which the authorization relates.

Appointment of Commissioner

15.1 (1) The Auditor General shall, in accordance with the *Public Service Employment Act*, appoint a senior officer to be called the Commissioner of the Environment and Sustainable Development who shall report directly to the Auditor General.

Commissioner's duties

(2) The Commissioner shall assist the Auditor General in performing the duties of the Auditor General set out in this Act that relate to the environment and sustainable development.

Responsibility for human resources management

16. The Auditor General is authorized, in respect of persons appointed in his or her office, to exercise the powers and perform the functions of the Treasury Board that relate to human resources management within the meaning of paragraph 7(1)(e) and section 11.1 of the *Financial Administration Act*, as well as those of deputy heads under subsection 12(2) of that Act, as that subsection reads without regard to any terms and conditions that the Governor in Council may direct, including the determination of terms and conditions of employment and the responsibility for employer and employee relations.

Delegation

16.1 (1) The Auditor General may authorize any person employed in his or her office to exercise and perform, in any manner and subject to any terms and conditions that he or she directs, any of his or her powers and functions in relation to human resources management.

Sub-delegation

(2) Any person authorized under subsection (1) may, subject to and in accordance with the authorization, authorize one or more persons under that person's jurisdiction to exercise any power or perform any function to which the authorization relates.

Contract for professional services

16.2 Subject to any other Act of Parliament or regulations made under any Act of Parliament, but without the approval of the Treasury Board, the Auditor General may, within the total dollar limitations established for his or her office in appropriation Acts, contract for professional services.

Classification standards

17. Classification standards may be prepared for persons employed in the office of the Auditor General to conform with the classifications that the Auditor General recognizes for the purposes of that office.

Delegation

18. The Auditor General may designate a senior member of his staff to sign on his behalf any opinion that he is required to give and any report, other than his annual report on the financial statements of Canada made pursuant to section 64 of the *Financial Administration Act* and his reports to the House of Commons under this Act, and any member so signing an opinion or report shall indicate beneath his signature his position in the office of the Auditor General and the fact that he is signing on behalf of the Auditor General.

Immunities

Immunity as witness

18.1 The Auditor General, or any person acting on behalf or under the direction of the Auditor General, is not a competent or compellable witness — in respect of any matter coming to the knowledge of the Auditor General or that person as a result of performing audit powers, duties or functions under this or any other Act of Parliament during an examination or inquiry — in any proceedings other than a prosecution for an offence under section 131 of the *Criminal Code* (perjury) in respect of a statement made under this Act.

Protection from prosecution

18.2 (1) No criminal or civil proceedings lie against the Auditor General, or against any person acting on behalf or under the direction of the Auditor General, for anything done, reported or said in good faith in the course of the performance or purported performance of audit powers, duties or functions under this or any other Act of Parliament.

Defamation

(2) For the purposes of any law relating to defamation,

(a) anything said, any information supplied or any document or thing produced in good faith by or on behalf of the Auditor General, in the course of the performance or purported performance of audit powers, duties or functions under this or any other Act of Parliament, is privileged; and

(b) any report made in good faith by the Auditor General in the course of the performance or purported performance of audit powers, duties or functions under this or any other Act of Parliament, and any fair and accurate account of the report made in good faith in a newspaper or any other periodical publication or in a broadcast, is privileged.

Estimates

Estimates

19. (1) The Auditor General shall annually prepare an estimate of the sums that will be required to be provided by Parliament for the payment of the salaries, allowances and expenses of his office during the next ensuing fiscal year.

Special report

(2) The Auditor General may make a special report to the House of Commons in the event that amounts provided for his office in the estimates submitted to Parliament are, in his opinion, inadequate to enable him to fulfil the responsibilities of his office.

Appropriation allotments

20. The provisions of the *Financial Administration Act* with respect to the division of appropriations into allotments do not apply in respect of appropriations for the office of the Auditor General.

Audit of the Office of the Auditor General

Audit of the office of the Auditor General

21. (1) A qualified auditor nominated by the Treasury Board shall examine the receipts and disbursements of the office of the Auditor General and shall report annually the outcome of his examinations to the House of Commons.

Submission of reports and tabling

(2) Each report referred to in subsection (1) shall be submitted to the President of the Treasury Board on or before the 31st day of December in the year to which the report relates and the President of the Treasury Board shall lay each such report before the House of Commons within fifteen days after receipt thereof by him or, if that House is not then sitting, on any of the first fifteen days next thereafter that the House of Commons is sitting.

Sustainable Development

Purpose

21.1 In addition to carrying out the functions referred to in subsections 23(3) and (4), the purpose of the Commissioner is to provide sustainable development monitoring and reporting on the progress of category I departments towards sustainable development, which is a continually evolving concept based on the integration of social, economic and environmental concerns, and which may be achieved by, among other things,

(a) the integration of the environment and the economy;

(b) protecting the health of Canadians;

(c) protecting ecosystems;

(d) meeting international obligations;

(e) promoting equity;

(f) an integrated approach to planning and making decisions that takes into account the environmental and natural resource costs of different economic options and the economic costs of different environmental and natural resource options;

(g) preventing pollution; and

(h) respect for nature and the needs of future generations.

Petitions received

22. (1) Where the Auditor General receives a petition in writing from a resident of Canada about an environmental matter in the context of sustainable development that is the responsibility of a category I department, the Auditor General shall make a record of the petition and forward the petition within fifteen days after the day on which it is received to the appropriate Minister for the department.

Acknowledgement to be sent

(2) Within fifteen days after the day on which the Minister receives the petition from the Auditor General, the Minister shall send to the person who made the petition an acknowledgement of receipt of the petition and shall send a copy of the acknowledgement to the Auditor General.

Minister to respond

(3) The Minister shall consider the petition and send to the person who made it a reply that responds to it, and shall send a copy of the reply to the Auditor General, within

(a) one hundred and twenty days after the day on which the Minister receives the petition from the Auditor General; or

(b) any longer time, where the Minister personally, within those one hundred and twenty days, notifies the person who made the petition that it is not possible to reply within those one hundred and twenty days and sends a copy of that notification to the Auditor General.

Multiple petitioners

(4) Where the petition is from more than one person, it is sufficient for the Minister to send the acknowledgement and reply, and the notification, if any, to one or more of the petitioners rather than to all of them.

Duty to monitor

23. (1) The Commissioner shall make any examinations and inquiries that the Commissioner considers necessary in order to monitor

(a) the extent to which category I departments have contributed to meeting the targets set out in the Federal Sustainable Development Strategy and have met the objectives, and implemented the plans, set out in their own sustainable development strategies laid before the House of Commons under section 11 of the *Federal Sustainable Development Act*; and

(b) the replies by Ministers required by subsection 22(3).

Commissioner's report

(2) The Commissioner shall, on behalf of the Auditor General, report annually to the House of Commons concerning anything that the Commissioner considers should be brought to the attention of that House in relation to environmental and other aspects of sustainable development, including

(a) the extent to which category I departments have contributed to meeting the targets set out in the Federal Sustainable Development Strategy and have met the objectives, and implemented the plans, set out in their own sustainable development strategies laid before that House under section 11 of the *Federal Sustainable Development Act*;

(b) the number of petitions recorded as required by subsection 22(1), the subject-matter of the petitions and their status; and

(c) the exercising of the authority of the Governor in Council under subsections 11(3) and (4) of the *Federal Sustainable Development Act*.

Duty to examine

(3) The Commissioner shall examine the report required under subsection 7(2) of the *Federal Sustainable Development Act* in order to assess the fairness of the information contained in the report with respect to the progress of the federal government in implementing the Federal Sustainable Development Strategy and meeting its targets.

Duty to report

(4) The Commissioner shall include in the report referred to in subsection (2) the results of any assessment conducted under subsection (3) since the last report was laid before the House of Commons under subsection (5).

Submission and tabling of report

(5) The report required by subsection (2) shall be submitted to the Speaker of the House of Commons and shall be laid before that House by the Speaker on any of the next 15 days on which that House is sitting after the Speaker receives it.

Appendix B Reports of the Standing Committee on Public Accounts to the House of Commons, 2009–10

The following reports have been tabled since our November 2009 Report went to print. They are available on the website of Canada's Parliament (www.parl.gc.ca).

40th Parliament, 2nd Session

Report 19—Chapter 5, Passport Services—Passport Canada, of the 2009 March Status Report of the Auditor General of Canada (Adopted by the Committee on 21 October, 2009; presented to the House on 6 November 2009)

Report 20—Chapter 5, Financial Management and Control—National Defence, of the Spring 2009 Report of the Auditor General of Canada (Adopted by the Committee on 18 November 2009; presented to the House on 3 December 2009)

Report 21—Chapter 3, Contracting for Professional Services—Public Works and Government Services Canada, of the December 2008 Report of the Auditor General of Canada (Adopted by the Committee on 18 November 2009; presented to the House on 3 December 2009)

Report 22—Power of Committees to Order the Production of Documents (Adopted by the Committee on 18 November 2009; presented to the House on 3 December 2009)

Report 23 –Chapter 7, Acquisition of Leased Office Space, of the 2006 May Status Report of the Auditor General of Canada (Place Victoria) (Adopted by the Committee on 25 November 2009; presented to the House on 10 December 2009)

40th Parliament, 3rd Session

Report 1—Following up on Recommendations made by the Standing Committee on Public Accounts in the 39th Parliament, 2nd Session (Adopted by the Committee on 16 March 2010; presented to the House on 29 March 2010)

Report 2—Chapter 2, The Governor in Council Appointments Process, of the 2009 March Status Report of the Auditor General of Canada (Adopted by the Committee on 16 March 2010; presented to the House on 29 March 2010)

Report 3—Chapter 7, Special Examinations of Crown Corporations – 2008, of the Spring 2009 Report of the Auditor General of Canada (Adopted by the Committee on 16 March 2010; presented to the House on 29 March 2010)

Report 4—Chapter 1, Gender-Based Analysis, of the Spring 2009 Report of the Auditor General of Canada (Adopted by the Committee on 16 March 2010; presented to the House on 14 April 2010)

Report 5—Chapter 1, Safeguarding Government Information and Assets in Contracting, of the October 2007 Report of the Auditor General of Canada (Adopted by the Committee on 16 March 2010; presented to the House on 14 April 2010)

Report 6—Chapter 3, Human Resources Management—Foreign Affairs and International Trade Canada, of the May 2007 Report of the Auditor General of Canada (Adopted by the Committee on 16 March 2010; presented to the House on 14 April 2010)

Report 7—Chapter 4, Interest on Advance Deposits from Corporate Taxpayers—Canada Revenue Agency, of the Spring 2009 Report of the Auditor General of Canada (Adopted by the Committee on 16 March 2010; presented to the House on 14 April 2010)

Report 8—Chapter 6, Selected Contribution Agreements—Natural Resources Canada, of the Spring 2009 Report of the Auditor General of Canada (Adopted by the Committee on 25 March 2010; presented to the House on 19 April 2010)

Report 9—Chapter 2, Intellectual Property, of the Spring 2009 Report of the Auditor General of Canada (Adopted by the Committee on 25 March 2010; presented to the House on 19 April 2010)

Report 10—Public Accounts of Canada 2009 (Adopted by the Committee on 1 April 2010; presented to the House on 28 April 2010)

Report 11—Chapter 7, Emergency Management—Public Safety Canada, of the Fall 2009 Report of the Auditor General of Canada (Adopted by the Committee on 15 April 2010; presented to the House on 28 April 2010)

Report 12—Chapter 3, Income Tax Legislation, of the Fall 2009 Report of the Auditor General of Canada (Adopted by the Committee on 15 April 2010; presented to the House on 28 April 2010)

Report 13—Chapter 2, Selecting Foreign Workers Under the Immigration Program, of the Fall 2009 Report of the Auditor General of Canada (Adopted by the Committee on 29 April 2010; presented to the House on 12 May 2010)

Report 14—Main Estimates 2010–2011: Vote 15 under FINANCE, and Part III—Report on Plans and Priorities and Departmental Performance Report of the Office of the Auditor General of Canada (Adopted by the Committee on 11 May 2010; presented to the House on 12 May 2010)

Appendix C Report on the audit of the President of the Treasury Board's report *Tabling of Crown Corporations Reports in Parliament*

Tablings in Parliament for parent Crown corporations: Annual reports and summaries of corporate plans and budgets

Section 152 of the *Financial Administration Act* (the Act) requires the President of the Treasury Board to lay before each House of Parliament a report on the timing of the tabling, by appropriate ministers, of annual reports and summaries of corporate plans and of budgets of Crown corporations. This report of the President of the Treasury Board is included in the 2010 *Annual Report to Parliament—Crown Corporations and Other Corporate Interests of Canada*, which must be tabled by 31 December.

The Act requires the Auditor General of Canada to audit the accuracy of the President of the Treasury Board's report on the timing of tablings and to present the results in her annual report to the House of Commons.

At the time that our annual report was going to print, we were unable to include the results of the above audit, since the President of the Treasury Board's report had not yet been finalized. The auditor's report, which is required by the Act, will therefore be included in the next Report of the Auditor General to the House of Commons. It will also be appended to this year's report of the President of the Treasury Board.

Appendix D Costs of Crown corporation audits conducted by the Office of the Auditor General of Canada

The Office is required, under section 147 of the *Financial Administration Act*, to disclose its costs incurred in preparing annual audit (Exhibit D.1) and special examination reports on Crown corporations.

An audit report includes an opinion on a corporation's financial statements and on its compliance with specified authorities. It may also include reporting on any other matter deemed significant.

A special examination determines whether a corporation's financial and management control and information systems and its management practices provide reasonable assurance that

- assets have been safeguarded and controlled;
- financial, human, and physical resources have been managed economically and efficiently; and
- operations have been carried out effectively.

In 2009–10, the Office completed the special examination of 10 Crown corporations. The costs incurred are in the following table:

Business Development Bank of Canada (joint audit)	$910,320
Canada Deposit Insurance Corporation	$357,582
Canada Post Corporation (joint audit)	$1,907,702
Canadian Commercial Corporation	$426,299
Enterprise Cape Breton Corporation	$405,093
Export Development Canada	$743,733
Marine Atlantic Inc.	$621,801
National Gallery of Canada	$820,510
National Museum of Science and Technology	$690,946
Standards Council of Canada	$381,296

Exhibit D.1 Cost of preparing annual audit reports for fiscal years ending on or before 31 March 2010

Crown corporation	Fiscal year ended	Cost ($)
Atlantic Pilotage Authority	31.12.09	117,001
Atomic Energy of Canada Limited (joint audit)	31.03.10	550,734
Blue Water Bridge Authority	31.08.09	168,005
Business Development Bank of Canada (joint audit)	31.03.10	492,813
Canada Council for the Arts	31.03.10	187,596
Canada Deposit Insurance Corporation	31.03.10	176,154
Canada Development Investment Corporation (joint audit)	31.12.09	160,304
Canada Employment Insurance Financing Board	31.03.10	76,070
Canada Hibernia Holding Corporation	31.12.09	73,685
Canada Lands Company Limited (joint audit)	31.03.10	652,867
Canada Mortgage and Housing Corporation (joint audit)	31.12.09	589,006
Canada Post Corporation (joint audit)	31.12.09	695,976
Canadian Air Transport Security Authority	31.03.10	472,801
Canadian Broadcasting Corporation	31.03.10	895,806
Canadian Commercial Corporation	31.03.10	243,160
Canadian Dairy Commission	31.07.09	266,817
Canadian Museum for Human Rights	31.03.10	153,634
Canadian Museum of Civilization	31.03.10	182,974
Canadian Museum of Nature	31.03.10	115,876
Canadian Race Relations Foundation	31.03.10	145,193
Canadian Tourism Commission	31.12.09	329,813
Cape Breton Development Corporation	31.12.09	215,198
Defence Construction (1951) Limited	31.03.10	76,100
Enterprise Cape Breton Corporation	31.03.10	266,110
Export Development Canada	31.12.09	1,074,803
Farm Credit Canada	31.03.10	659,050
Federal Bridge Corporation Limited, The	31.03.10	118,265
First Nations Statistical Institute	31.03.10	68,491
Freshwater Fish Marketing Corporation	30.04.09	248,840
Great Lakes Pilotage Authority	31.12.09	150,919
International Development Research Centre	31.03.10	200,601
Jacques Cartier and Champlain Bridges Incorporated, The	31.03.10	142,804
Laurentian Pilotage Authority	31.12.09	110,823
Marine Atlantic Inc.	31.03.10	306,570
National Arts Centre Corporation	31.08.09	274,788
National Capital Commission	31.03.10	330,251
National Gallery of Canada	31.03.10	195,137
National Museum of Science and Technology	31.03.10	148,360
Old Port of Montréal Corporation Inc.	31.03.10	256,851
Pacific Pilotage Authority	31.12.09	94,449

Exhibit D.1 Cost of preparing annual audit reports for fiscal years ending on or before 31 March 2010 (continued)

Crown corporation	Fiscal year ended	Cost ($)
Parc Downsview Park Inc.	31.03.10	153,667
Public Sector Pension Investment Board (joint audit)	31.03.10	518,402
Public-Private Partnerships Canada Inc. (joint audit)	31.03.10	110,576
Ridley Terminals Inc.	31.12.09	169,467
Royal Canadian Mint	31.12.09	634,510
Seaway International Bridge Corporation Ltd., The	31.03.10	122,868
Standards Council of Canada	31.03.10	91,910
Telefilm Canada	31.03.10	179,374
VIA Rail Canada Inc.	31.12.09	710,961

Report of the Auditor General of Canada to the House of Commons—Fall 2010

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Chapter 9 Animal Diseases—Canadian Food Inspection Agency

2010



FALL

Report of the

Auditor General of Canada

to the House of Commons

Chapter 1
Canada's Economic Action Plan

Office of the Auditor General of Canada



2010



Report of the

Auditor General of Canada

to the House of Commons

FALL

Chapter 1

Canada's Economic Action Plan

Office of the Auditor General of Canada

The Fall 2010 Report of the Auditor General of Canada comprises Matters of Special Importance, Main Points—Chapters 1 to 9, Appendices, and nine chapters. The main table of contents for the Report is found at the end of this publication.

The Report is available on our website at www.oag-bvg.gc.ca.

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Chapter

1

Canada's Economic Action Plan

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Canada's Economic Action Plan

Main Points

What we examined

In late 2008 and early 2009, Canada was in the midst of a global economic downturn. The federal budget in January 2009, titled Canada's Economic Action Plan, was designed to respond to this downturn by stimulating the economy, in part by increasing government spending for sectors of the economy and regions of the country in need. The Economic Action Plan sought to stimulate spending by Canadians, stimulate housing construction, build infrastructure, and support businesses and communities. Together, these initiatives amounted to about $40 billion, with an additional $12 billion funded by the provinces and territories. These amounts were subsequently increased to about $47 billion in federal stimulus and $14 billion from provinces and territories. Budget 2009 also contained measures to add stability to the financial sector, which sought to improve access to financing for consumers and business by providing up to $200 billion in credit.

Over 35 federal entities worked to deliver close to 90 programs in support of the Economic Action Plan. In many cases, funding for existing programs was "topped up" with additional funds; other programs were modified to reflect the economic circumstances. Some programs were completely new. In most cases, funds were made available for a fixed two-year period. Any costs incurred beyond the deadline would not be funded by the federal government. Many of the programs were coordinated and delivered through provinces, territories, municipalities, third parties, non-governmental organizations, and the private sector; we did not audit their delivery of programs.

We audited the Economic Action Plan as it was being delivered. We looked at how programs were designed and delivered and what steps were taken to ensure that only eligible projects were funded. We selected 11 programs for examination and also looked at the role of internal audit. Our audit included the role played by central agencies—the Privy Council Office, the Treasury Board of Canada Secretariat, and the Department of Finance Canada. We also examined compliance with financial management and environmental requirements.

Audit work for this chapter was substantially completed on 27 April 2010. We plan to carry out a second audit that will focus on how the stimulus money was spent.

Why it's important

The global recession caused significant job losses in key sectors of the economy, such as the construction and forestry sectors. Expecting that the downturn could be temporary, the government proposed temporary, targeted programs designed to inject about $40 billion in stimulus spending into the Canadian economy, which was subsequently increased to about $47 billion. This represents about 2.9 percent of GDP.

An initiative as large and complex as the Economic Action Plan imposed a significant increase in workload on federal departments. As speed of delivery was of the essence, officials were under pressure to quickly design, deliver, monitor, and report on new or accelerated federal programs while continuing to deliver their existing programs. Together, these factors increased the risk that mistakes could be made. At the same time, there was concern that if the stimulus money were delayed or allocated too close to the end of the two-year time frame, it would not meet immediate, short-term needs.

What we found

- Central agencies and departments took steps to ensure that programs were designed and processes streamlined to allow individual projects to be selected and funds to be allocated quickly. For example, the Privy Council Office and Treasury Board of Canada Secretariat used an accelerated process to speed up the policy and financial approvals for many Economic Action Plan programs, such as the Knowledge Infrastructure Program. As a result, the total time needed to design, review, and approve programs was reduced from the approximately six months normally required to two months.
- All the projects we reviewed met the eligibility criteria as set out in the program terms and conditions. Important considerations for eligibility were that projects would start quickly and be substantially completed by 31 March 2011. However, we noted that some projects started late, and it is not clear whether they will be completed on time. In addition, decisions on whether an environmental assessment was required for some projects were made on the basis of insufficient information gathered from applicants. As a result, it is unclear whether some projects that were approved should have undergone an environmental assessment.

- Central agencies and departments all paid considerable attention to risk. Risks were assessed and controls and mitigation strategies were put in place. Capacity to deliver the Economic Action Plan within the short time frame was a significant risk facing departments, and senior management implemented additional controls to manage this risk. In addition, the Office of the Comptroller General of Canada worked closely with departmental internal audit groups to help address risks. Departmental internal audit groups adjusted their audit plans to focus on areas of greater risk and provided appropriate advice and assurance to management.
- The government met the requirement to provide Parliament with quarterly progress reports on the implementation of the Economic Action Plan. However, the project-level information on jobs included in the quarterly reports was largely anecdotal and did not present a complete picture of all jobs created, nor did it include information on jobs created or maintained for all Economic Action Plan programs. Because of these data limitations, the government reported a macroeconomic estimate of jobs created or maintained as of January 2010. The total number of jobs created or maintained under the Economic Action Plan remains to be fully measured. The Department of Finance Canada has indicated this will be done through a macroeconomic estimate once the Plan is completed.

The entities have responded. The entities have agreed or generally agreed with our recommendations. Their detailed responses follow the recommendations throughout the chapter, as applicable.

Introduction

1.1 In late 2008 and early 2009, Canada was in the midst of a global economic downturn. The 2009 federal Budget was titled Canada's Economic Action Plan. It was designed to respond to this situation by stimulating the economy through, in part, increasing government funding for public projects. The government announced that immediate action was required and that it would streamline the approval process for infrastructure projects that were ready to start.

1.2 The Economic Action Plan sought to build infrastructure, stimulate spending by Canadians, stimulate housing construction, and support businesses and communities. Together these initiatives amounted to approximately $40 billion of spending over the Economic Action Plan's two-year time frame and involved a further $12 billion provided by the provinces and territories. These amounts were subsequently increased to about $47 billion in federal stimulus and $14 billion from provinces and territories. Budget 2009 also contained measures to add stability to the financial sector, which sought to improve access to financing for consumers and business by providing up to $200 billion in credit.

1.3 The stimulus initiative was complex. Close to 90 programs were included in the Economic Action Plan. They were delivered by over 35 federal entities, along with provinces, territories, municipalities, non-governmental organizations, and the private sector. The programs were designed to stimulate economic activity through the use of **contributions**, grants, contracts, capital spending, and tax relief. Introducing new programs within a tight time frame while continuing to deliver existing programs introduced or increased various risks.

Contributions—Conditional transfer payments to an individual or organization for a specified purpose. These payments are pursuant to a contribution agreement and are subject to being accounted for and audited.

Focus of the audit

1.4 We audited selected Economic Action Plan programs as they were being delivered. Specifically, we focused our audit on whether selected federal entities had

- implemented appropriate management frameworks for oversight and risk assessment in planning their delivery of the Economic Action Plan;
- put necessary controls in place to adequately mitigate the assessed risks, including compliance with federal environmental assessment requirements;

- approved Economic Action Plan funds to eligible recipients in a timely manner while respecting relevant authorities and key controls;
- put adequate processes in place to monitor and report on Economic Action Plan progress and performance; and
- assigned departmental internal audit functions to provide appropriate advice and assurance to senior officials that internal controls and management practices were adequate for the management of expenditures under the Economic Action Plan.

1.5 Our audit examined the delivery of infrastructure spending by 12 departments and agencies responsible for 11 programs as well as the central agencies that provided program direction and guidance (Exhibit 1.1). We also examined an internal audit conducted by Human Resources and Skills Development Canada.

1.6 As our audit was conducted before the Economic Action Plan was fully implemented, we plan to conduct a second audit that will focus on program delivery and will examine whether the projects undertaken were completed as intended. It may include a further examination of whether the reporting and monitoring information collected on the programs and projects was sufficient to allow the government to determine the level of progress made toward attaining the objectives of the Economic Action Plan. In addition, we may conduct an audit of environmental issues associated with the Economic Action Plan.

1.7 More details about the audit objectives, scope, approach, and criteria are in **About the Audit** at the end of this chapter.

Observations and Recommendations

1.8 The government's objective for the Economic Action Plan was to stimulate the economy in the immediate term. The government faced a number of challenges. Key among these was to develop, implement, and deliver $40 billion of stimulus spending within two years.

1.9 In this first audit of the Economic Action Plan, which looked at the design, approval, and delivery of selected Economic Action Plan programs, we examined the programs' timeliness, the programs' compliance with eligibility and legal requirements, the departments' assessment of and response to risks, and the reporting to Parliament.

Exhibit 1.1 Entities and Economic Action Plan programs audited

Responsible entities	Programs audited
• Infrastructure Canada	• Infrastructure Stimulus Fund • Building Canada Fund—Communities Component*
• Industry Canada	• Knowledge Infrastructure Program • Marquee Tourism Events Program
• Indian and Northern Affairs Canada	• First Nations Schools Projects • First Nations Water and Wastewater Projects • First Nations On-Reserve Housing Program
Regional development agencies: • Atlantic Canada Opportunities Agency • Canadian Northern Economic Development Agency • Economic Development Agency of Canada for the Regions of Quebec • Federal Economic Development Agency for Southern Ontario • Western Economic Diversification Canada	• Building Canada Fund—Communities Component* • Community Adjustment Fund • Recreational Infrastructure Canada Program
• Public Works and Government Services Canada	• Investing in Federal Buildings
• Agriculture and Agri-Food Canada • Transport Canada • Natural Resources Canada	• Modernizing Federal Laboratories
Central agencies: • Treasury Board of Canada Secretariat • Department of Finance Canada • Privy Council Office	• Role of central agencies in support of the above programs • Reporting to Parliament

*Infrastructure Canada is responsible for the Building Canada Fund—Communities Component program. The program is delivered by the regional development agencies.

Ensuring timeliness

1.10 The government's objective for timeliness of Economic Action Plan projects was set out in Budget 2009: to spend stimulus money and complete projects by 31 March 2011. We looked at the government's efforts to achieve this timeline. We focused on measures undertaken to accelerate policy and financial approvals and streamline rules and regulations. We examined the role of central agencies (the Privy Council Office, Department of Finance Canada, and Treasury Board of Canada Secretariat) and 12 departments and agencies in helping to achieve these objectives.

1.11 Delivering stimulus funding quickly depended on many factors. Putting in place the policy approvals and authorities for the Economic Action Plan required the coordinated efforts of departments, the Privy Council Office (PCO), Department of Finance Canada, and Treasury Board of Canada Secretariat to support Cabinet committees, including the Treasury Board. To deliver each program required defining terms and conditions and how these would be applied for each program. As with all programs, compliance with legislation was an important requirement.

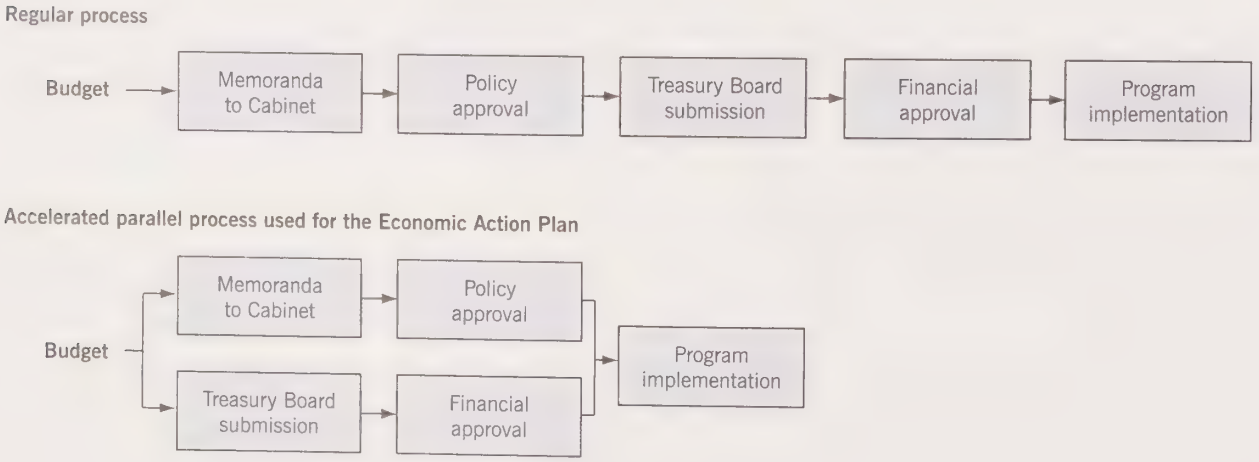
Central agencies accelerated program design and approval

1.12 Our audit examined PCO and the Secretariat's efforts to speed up Economic Action Plan policy and financial approvals. The regular process is that before any new program can be implemented, it needs policy approval from Cabinet and then financial approval from the Treasury Board, which includes expenditure, program, and project authority. This process usually takes about six months. An accelerated parallel process was used for the Economic Action Plan (Exhibit 1.2). (Existing programs that are receiving additional funding generally need only financial approval before proceeding.)

Exhibit 1.2 Policy and financial approvals for the Economic Action Plan were accelerated

The Privy Council Office (PCO) supports Cabinet committees in reviewing the contents of departmental draft memoranda to Cabinet. Policy analysis is prepared by departments and the PCO for discussion and approval by Cabinet committees. This process usually occurs before financial approval is sought from the Treasury Board.

The Treasury Board of Canada Secretariat provides a similar review of departmental draft submissions before their presentation to the Treasury Board for financial approval, which includes expenditure, program, and project authority.



1.13 We examined the extent to which PCO provided advice to departments on Economic Action Plan program submissions for discussions by Cabinet committees. We also examined the extent to which the Secretariat reviewed departmental draft submissions while taking into account program risks, sound stewardship, transparency, and accountability. Through interviews and document review, we examined PCO and the Secretariat's role in helping to design and challenge the 11 programs in Exhibit 1.1.

1.14 The Privy Council Office and the Secretariat accelerated their assessment of departmental submissions to Cabinet and to the Treasury Board for compliance with pertinent legislation, policies, and authorities. We found that the accelerated review process that PCO and the Secretariat followed allowed for projects to begin construction in the summer of 2009. Other work was put aside, and measures that are normally undertaken sequentially occurred simultaneously. For many programs, the review of documents for Cabinet committees and submissions for Treasury Board financial approval occurred at the same time (Exhibit 1.2). Consequently, the total time needed to design, review, and approve new Economic Action Plan programs was reduced from approximately six months to two months.

Main Estimates—The documents that identify the spending authorities (also called votes) of the departments and agencies, for which the government must seek Parliament's approval annually. A vote is an individual item in the Main Estimates indicating the amount of funds required by the government for particular activities or programs.

Central vote—A vote (spending authority) that Parliament approves giving authority to the Treasury Board to allocate funds from the vote directly to departments when the amounts and conditions have been approved.

Supplementary Estimates—The documents that identify the spending authorities (votes) and amounts and adjustments not included in the Main Estimates. Parliamentary approval is required to enable the government to proceed with its spending plans. Supplementary Estimates documents are normally tabled three times a year—late spring, late fall, and early spring.

1.15 As Budget 2009 was tabled in late January, there was insufficient time to incorporate budget items in the **Main Estimates** of each department prior to the start of the 2009–10 fiscal year. To expedite the allocation of funds for Economic Action Plan programs, a new **central vote**, Treasury Board (TB) Vote 35, was included in the 2009–10 Main Estimates in the amount of $3 billion. This vote was designed to be a temporary measure to allocate funds between 1 April and 30 June 2009. The Treasury Board delegated to the President of the Treasury Board the authority to allocate funds from TB Vote 35 to departments for programs that would otherwise have been funded through **Supplementary Estimates**. Specifically, it allowed funds to be allocated before late June, the first opportunity to adjust the Estimates when the first Supplementary Estimates were approved by Parliament.

1.16 Between 1 April and 30 June 2009, approximately $2.1 billion was allocated from TB Vote 35 to government departments. We examined the government's use of Vote 35, as administered by the Treasury Board of Canada Secretariat.

1.17 The Secretariat's internal audit function performed an internal audit of the management of TB Vote 35 within the Secretariat. The quality of the TB Vote 35 audit allowed us to accept its audit findings and rely on its work. Based on our review of this audit work, we

concluded that the Secretariat had developed and documented clear assessment criteria that were well-defined and consistently applied. Furthermore, we found the funding allocations requested by the departments that were approved by Treasury Board were properly recorded and reported.

1.18 To advance the start of projects, programs were designed to allow applicants to incur costs at their own risk once their project was announced by the minister. Under normal circumstances, applicants would need to wait for all the formal approvals to be in place, including a signed contribution agreement, before beginning construction. By doing this, project applicants could start earlier, but accepted a certain amount of risk as costs incurred prior to signing would be reimbursed only once a formal agreement was signed.

1.19 In addition, increased delegation of spending authority for ministers allowed them to sign agreements without having to return to Treasury Board for additional approvals. This resulted in less central agency oversight and challenge of significant expenditures but allowed for speedier implementation. Due to the circumstances, the government accepted additional risk and based its decision, in part, on the Secretariat's knowledge of the departments and previous assessments of the departments' management accountability frameworks.

Departments designed programs to allow for timely implementation

1.20 Departments delivering new stimulus programs had to complete the design of these programs while providing for speedy implementation. Delayed implementation would delay the Economic Action Plan's stimulus effect. For each of the new contribution programs, departments needed to define terms and conditions for eligibility, funding, and payment requirements, and how projects under each program would be delivered, monitored, and reported.

1.21 To determine whether departments designed programs to meet the objectives of the Economic Action Plan and to be in compliance with approved terms and conditions, we reviewed departmental memoranda to Cabinet and Treasury Board submissions for the 11 programs in Exhibit 1.1.

1.22 We found that the programs we examined were designed in a manner to allow for timely implementation while maintaining suitable controls. For example, some stimulus programs were modelled on or used existing frameworks to the extent possible to accelerate

implementation. Others built on regional development programs and used an existing network of regional staff who could review proposals and monitor delivery.

1.23 Examples include the Community Adjustment Fund and Recreational Infrastructure Canada Program, which were delivered by regional development agencies using their existing model for infrastructure programs. Infrastructure Canada, along with regional development agencies, delivered the Building Canada Fund—Communities Component. Another example is Public Works and Government Services Canada, which accelerated its existing plans for repair and renovation of federal buildings.

Most programs began implementation in a timely manner

1.24 The accelerated review by the PCO and the Secretariat, along with actions taken by departments, allowed for a faster start to implementation. We examined whether selected departments had implemented Economic Action Plan programs in a timely manner. We looked at the receipt of applications and the time it took to process and approve applications.

1.25 There were a number of tools used to speed the selection and implementation of certain programs. For example, we found that Infrastructure Canada enhanced an existing electronic database to support the delivery of the Infrastructure Stimulus Fund and Building Canada Fund—Communities Component. Applications were made online directly to the database, which was expanded to allow for recipients to input their project progress reports and claims for payment of eligible costs. If an Infrastructure Stimulus Fund project was behind schedule, the system was designed to increase monitoring. Other programs, such as the Recreational Infrastructure Canada Program and the Community Adjustment Fund delivered by regional development agencies, also used online applications in order to speed up project selection.

1.26 Another example of speedy implementation was the Knowledge Infrastructure Program, administered by Industry Canada, a cost-shared program to fund infrastructure projects at universities and community colleges. Matching funding was provided predominately through federal–provincial funding agreements. To quicken the application process, the federal government, with the agreement of most provinces and territories, corresponded directly with post-secondary institutions. In the case of federal–provincial agreements, priority projects were then

identified with the provinces and approved by federal and provincial ministers, in order to speed up the joint approval of the projects.

1.27 We also found examples where program implementation was delayed from the original target of 120 days announced in Budget 2009. For example, three programs delivered by Indian and Northern Affairs Canada to First Nations—on-reserve housing, water and wastewater, and school infrastructure projects—took longer to start. Based on management's assessment of risks, the Department put additional controls in place over these projects. To reduce risk, the Department allowed construction to start for most of these projects only after contribution agreements between the federal government and First Nations were signed. These agreements were signed beginning in August 2009 and, as a result, some projects missed the summer 2009 construction season. It is the Department's position that this delay will not have an impact on the projects meeting the 31 March 2011 construction deadline.

1.28 We found that the government used a variety of tools and practices that responded to the need to speed up the process to allow Economic Action Plan programs to be delivered within the two-year period.

Complying with eligibility and legal requirements

1.29 The eligibility criteria for stimulus programs were flexible and broad and intended to target sectors of the economy and regions of the country in need. The government stated that it was important that the stimulus went to areas that would most benefit from support. The Economic Action Plan had three guiding principles: that stimulus funding should be timely, targeted, and temporary.

1.30 Important aspects of eligibility included that projects would be construction ready, implemented in a timely manner to meet the 31 March 2011 deadline, and in compliance with existing legal and policy requirements. We reviewed a sample of 410 projects from 9 programs and examined whether these approved projects met eligibility requirements:

- Building Canada Fund—Communities Component,
- Infrastructure Stimulus Fund,
- Community Adjustment Fund,
- Recreational Infrastructure Canada Program,
- Knowledge Infrastructure Program,
- Marquee Tourism Events Program,

- First Nations On-Reserve Housing Program,
- Investing in Federal Buildings, and
- Modernizing Federal Laboratories.

In addition, we reviewed 12 First Nations on-reserve schools and 18 water and wastewater projects that were identified in Budget 2009.

1.31 At the time of our audit, for all programs that required applications, the total value of applications submitted was greater than the available funds (Exhibit 1.3). For some programs like the Marquee Tourism Events Program, applications were accepted for events to be held in 2009 and in a second phase for events scheduled to begin in 2010. Other programs, like the Infrastructure Stimulus Fund, used an ongoing application process.

Exhibit 1.3 Project applications outnumbered projects approved

Economic Action Plan program	Number of project applications submitted	Number of project applications approved
Building Canada Fund—Communities Component	2,802	537
Community Adjustment Fund	2,519	800
First Nations On-Reserve Housing Program	11,647	2,756
Infrastructure Stimulus Fund	7,244	4,015
Knowledge Infrastructure Program	944	536
Marquee Tourism Events Program[1]	165	60
Modernizing Federal Laboratories	116	89
Recreational Infrastructure Canada Program	3,764	1,939

[1] Only projects from the 2009 calendar year were reviewed as part of this audit.

Source: Departments and agencies responsible for the programs, as of 27 April 2010

Projects funded met eligibility requirements based on information in applications

1.32 Applicants were required to complete and submit an application that demonstrated their project met the terms and conditions of each program. The most important aspect of eligibility common to all programs was that projects would be completed, or for some programs substantially completed, before the 31 March 2011 deadline. For most programs, this was based on a signed attestation by the applicant. Departmental officials assessed the applications to determine whether

projects met the eligibility criteria and could be recommended for approval. For all contribution programs except the First Nations On-Reserve Housing Program, ministers made the final selection among eligible projects. In the case of the First Nations On-Reserve Housing Program, regional officials were responsible for reviewing, selecting, and approving projects. We found that all projects in our sample met the eligibility requirements based on information in applications. Details for some of the programs we audited follow.

1.33 **Infrastructure Stimulus Fund.** This $4-billion stimulus program targeted provincial, territorial, and municipal construction-ready infrastructure rehabilitation projects. To be eligible for the Infrastructure Stimulus Fund, applicants had to attest that their project was construction ready and would not otherwise have been constructed by 31 March 2011 without the federal funding requested. Applicants also had to indicate whether their project plan was completed, and whether all permits and necessary approvals were in place. All of the projects that we tested for the Infrastructure Stimulus Fund met the eligibility criteria.

1.34 **Knowledge Infrastructure Program.** This program allocated $2 billion over two years. The program and funding targeted post-secondary institutions across Canada for deferred maintenance, repair, and expansion of projects to improve the quality of research and development and to deliver advanced knowledge and skills training. To be eligible for Knowledge Infrastructure Program funding, applicants had to attest that the project was a priority of the institution and would be materially completed by 31 March 2011. They also had to supply information on their project's readiness, which included the date of approval by the institution's board of governors and completion of engineering designs. All of the Knowledge Infrastructure Program projects that we tested showed that these criteria were met.

1.35 **Marquee Tourism Events Program.** This program allocated $100 million over two years to annual recurring world-class events that were well established and whose management had substantial experience in programming successful events. Applicants had to attest that the organization would not have the necessary resources to proceed with the proposed project without federal government support and that all expenses incurred would enhance the tourism event. Among other things, applicants had to provide audited financial statements and demonstrate that the event had been in existence for at least three years. We found that all of the Marquee Tourism Events Program projects that we tested met the eligibility criteria.

1.36 Economic Action Plan programs at Human Resources and Skills Development Canada. The Department delivers a range of labour market and social development programs across the country. It performed an internal audit of its control frameworks to support program eligibility for Economic Action Plan programs. Eligibility criteria, assessment, and approval processes were clearly established and communicated in a timely manner to internal and external stakeholders. Our review of the audit work supported the conclusions, allowing us to rely on this audit. Files demonstrated that all projects sampled were eligible, and that criteria, assessment, and approval processes were applied in an adequate and consistent manner.

1.37 Modernizing Federal Laboratories. This program allocated $250 million over two years. Investments were made in laboratories that contribute to core federal regulatory responsibilities, advance science and technology capacity, and/or enhance the health and safety of Canadians. We examined laboratory projects at Natural Resources Canada, Agriculture and Agri-Food Canada, and Transport Canada. We looked to see if the departments had designed and put in place appropriate management control frameworks to deliver this initiative. For the projects undertaken by Natural Resources Canada, we relied on the findings of an internal audit that it conducted of its Accelerated Infrastructure Program. We found that all projects sampled were eligible and that key controls were effectively designed and were in place for these departments.

Some project delays were encountered

1.38 Program officials relied on the information provided in project applications as confirmation that projects were construction ready. We found that, despite the information provided in the application, many of these infrastructure projects did not proceed on the start date stated in the application. There were a number of reasons for the delays, including that projects were not, in fact, construction ready, or that departmental approval was provided after the start date proposed by the applicant. Project delays increase the risk that projects will not meet the completion deadline of 31 March 2011. Departmental officials for the Infrastructure Stimulus Fund at Infrastructure Canada told us that they have responded by increasing the monitoring of how work on delayed projects is progressing, allowing them to better determine whether projects will be completed by the deadline. Additionally, the contribution agreements allow for projects to be removed or replaced if required.

Strategic environmental assessments were required for programs

1.39 Several of the new programs under the Economic Action Plan support infrastructure projects that could involve risks to the environment. Under a Cabinet directive, new programs requiring approval by a minister or Cabinet are subject to a strategic environmental assessment (SEA) at the planning stage to assess the program's potential environmental impacts.

1.40 We examined whether SEAs were conducted for new Economic Action Plan programs in accordance with the Cabinet directive. We reviewed SEAs for the Knowledge Infrastructure Program, the Marquee Tourism Events Program, the Infrastructure Stimulus Fund, and the Recreational Infrastructure Canada Program. We found that SEAs were completed and that they covered the necessary components required by the directive. However, we did not audit the underlying analysis contained in their SEAs.

Decisions to exempt some projects from environmental assessment were based on insufficient information

1.41 Whether an environmental assessment is required at the project level is another factor considered during project selection. Federal funding for infrastructure projects may trigger the need for an environmental assessment. The government stated in Budget 2009 that such assessments could lead to project delays. We found that departments gave priority to, among other things, infrastructure projects that either did not require an environmental assessment, or, where such an assessment was required, it would not impede the applicant's ability to complete the project by 31 March 2011.

1.42 Certain infrastructure projects may proceed without an environmental assessment. As part of the Economic Action Plan, the government introduced additional exclusions, thereby eliminating the need for environmental assessments for a wider range of projects. This was done through changes to the Exclusion List Regulations under the *Canadian Environmental Assessment Act*. In order to bring about the changes quickly, the regulations were not released in draft form for public comment before they took effect. As stated in the regulations, the new exclusions were intended to be temporary and were slated to expire on 31 March 2011. Through legislation implementing Budget 2010, these exemptions from environmental assessment requirements became permanent for certain infrastructure programs. Most of the new exclusions from environmental assessment requirements were subject to conditions. For example, federal

authorities must determine whether proposed projects are located within 250 metres of any local, regional, provincial, or federal **environmentally sensitive area** before considering them for exclusion from a federal environmental assessment. Projects that are close to local, regional, and provincial environmentally sensitive areas can still be excluded from undergoing a federal environmental assessment, provided the proposed project is consistent with applicable laws and the approved management plan for these areas.

Environmentally sensitive area—An "area protected for environmental reasons in regional or local land use plans, or by a local, regional, provincial or federal government body" (as defined by the *Canadian Environmental Assessment Act*). Examples of environmentally sensitive areas are designated wetlands, national or provincial parks, wildlife/conservation areas, areas of critical habitat for species at risk, heritage rivers, and areas of natural or scientific interest

1.43 Infrastructure Canada informed us that 93 percent of the project proposals it reviewed for the Infrastructure Stimulus Fund were excluded from environmental assessment. The Department relied on information provided by other levels of government and organizations in their application forms and performed minimal additional verification to determine whether a project could be excluded from an environmental assessment or not. The Infrastructure Stimulus Fund application form collected information on federal environmentally sensitive land for projects; however, information on provincial, regional, and local environmentally sensitive areas was only collected for buildings and not other types of projects. Infrastructure Canada relied on the provincial, regional, and municipal governments in order that projects submitted for funding consideration adhered to the relevant laws and management plans for the various provincial, regional, and local environmentally sensitive areas. As a result, the design of the application form was critical to gathering correct and complete information about a project and its surroundings, including environmentally sensitive areas.

1.44 During our testing of a sample of 52 approved projects, we found that all projects were excluded from environmental assessment under the new Regulations, but 35 of these 52 projects lacked sufficient information to make the determination about whether an exclusion was warranted. These gaps were due to weaknesses in the design of the Infrastructure Stimulus Fund application form.

1.45 Subsequent to our audit work, and in response to our findings, the Department carried out further analysis of the 35 projects without conducting site visits. As a result, the Department now is of the view that all 35 projects meet the appropriate criteria to be excluded from requiring a federal environmental assessment. We did not audit this information. Due to the insufficient information to support the Department's original determinations, we may further examine environmental issues associated with Economic Action Plan infrastructure projects in future audit work of the Commissioner of the Environment and Sustainable Development.

Assessing and responding to risks

1.46 The government recognized that the short time frame to develop and implement the new and accelerated programs increased the risk that mistakes could be made in Economic Action Plan program delivery, such as flawed program design or the reimbursement of ineligible project costs. We examined management controls to address these risks, including the Treasury Board of Canada Secretariat's review and challenge function of departmental submissions for programs. We looked at the capacity of departments to accelerate program implementation. Finally, we looked at the role of the Office of the Comptroller General of Canada and the internal audit community to help managers identify and respond to risks.

The Treasury Board of Canada Secretariat helped to assess and respond to risk

1.47 In our examination of the Secretariat's review of departmental submissions, we looked at the extent to which the Secretariat provided departments with advice and feedback on their draft submissions. Typically, Secretariat analysts review the content of departmental submissions to make certain that they are complete and that departments have included a thorough analysis of their proposed program, including program delivery, financial authorities, policy requirements, and capacity to deliver the program. We found that the Secretariat performed a suitable review of these departmental draft submissions and provided departments with guidance and support.

1.48 Capacity to deliver the Economic Action Plan within short time frames was identified as a significant challenge facing departments. Limited administrative capacity in federal departments was a risk because it could have delayed the Economic Action Plan's implementation and impeded the stimulus effects on the economy. We examined whether the Secretariat assessed departmental capacity as part of its review of departmental Treasury Board submissions.

1.49 We found that the Secretariat worked with departments to assess their administrative capacity to deliver Economic Action Plan programs. This assessment provided the rationale for additional resources for program administration for some departments. We found that 10 of the departments we audited received additional resources for program delivery.

1.50 To address capacity gaps, we observed that many departments reassigned existing staff and hired temporary staff to manage the large number of project applications. In one department, a shift was added to accommodate the heavy workload. While considerable effort was

made, several department officials informed us that this level of effort would not be sustainable over the long term.

1.51 As well, oversight committees of senior officials were established in departments to assess and manage Economic Action Plan risks, including capacity issues and increased spending authority. For example, we found that Infrastructure Canada, Indian and Northern Affairs Canada, and Industry Canada used senior management committees to provide oversight on the following:

- A project review panel at Infrastructure Canada, composed of the Associate Deputy Minister and assistant deputy ministers, reviewed all Infrastructure Stimulus Fund projects recommended by program staff prior to forwarding them to the Minister for final approval.
- A departmental operations committee at Indian and Northern Affairs Canada reviewed the Department's on-reserve Economic Action Plan projects on an ongoing basis.
- Industry Canada conducted ongoing monitoring, mitigation, and reporting of risks associated with its Economic Action Plan programs to senior management.

1.52 The internal audit function in departments is intended to play an important role in supporting departmental operations to help assess and manage risks. Internal audit can add value by providing independent advice and assurance that management controls in place are effective in ensuring that the organization is achieving its objectives. The Comptroller General of Canada is responsible for focused, sustained functional leadership of internal audit across government in order to build and develop capacity; ensure adequate levels of professionally qualified resources; and ensure adherence to professional standards and rigorous methodology in the delivery of internal audits.

1.53 Beginning in February 2009, the Office of the Comptroller General initiated a series of quarterly meetings with the chief audit executives of federal entities most affected by the Economic Action Plan. The Office of the Comptroller General organized sessions to discuss risk assessment and mitigation strategies. Working together with internal auditors, the Office of the Comptroller General identified the principles for internal auditing with respect to the Economic Action Plan. The principles for internal auditing included providing credible information using a variety of tools and providing timely results that still allowed for mid-course correction while ensuring that

internal auditors maintained their independence and objectivity. We found that the ongoing dialogue and guidance helped to disseminate best audit practices and to identify potential risks presented by the Economic Action Plan.

Departmental internal auditors provided advice and assurance

1.54 Departmental internal auditors provided advice and assurance on whether the management control frameworks were in place and functioning as intended. For some of the Economic Action Plan programs, internal auditors had assisted by providing advisory services to management at the beginning of program implementation, as well as putting in place detailed plans to provide audit level assurance during the later stages of delivery.

1.55 A key step in assessing the impacts and potential risks of implementing initiatives associated with the Economic Action Plan was to include these new risks in the departments' risk-based audit plans. A risk-based audit plan identifies these risks for mitigation by senior management and the departmental audit committee with a detailed schedule of planned audit activities and an overview of potential areas for audit. For the departmental audit committee meetings that we attended, we noted that Economic Action Plan programs included in departments' risk-based audit plans were discussed on an ongoing basis.

1.56 For 10 departments (see About the Audit for details), we looked at whether management had identified any new risks associated with the implementation of the Economic Action Plan, and, when necessary, whether internal auditors adjusted their risk-based audit plans. We looked to see if any new advisory or assurance work related to Canada's Economic Action Plan had been identified and planned in a timely and proactive manner. We found that, without exception, all of the risk-based audit plans had considered and, where necessary, taken into account the impacts and associated risks of implementing the Economic Action Plan.

1.57 For Industry Canada, Infrastructure Canada, Indian and Northern Affairs Canada, Natural Resources Canada, and Public Works and Government Services Canada, we looked at whether their internal audit functions had provided advisory services to senior management with respect to addressing the risks associated with implementing the Economic Action Plan. We found that internal auditors provided management with timely information and adequate advisory services. For example, management at Natural Resources

Canada requested that internal audit provide it with advice on the design of its management control framework. Management informed us that this advice was helpful in order to correct identified weaknesses in the control framework as the program was being implemented.

1.58 This advice allowed senior management to see if their Economic Action Plan programs were on track and allowed for mid-course corrections, if necessary. Deputy ministers and external audit committee members of these departments told us that they were satisfied with the advice and assurances that internal audit had provided.

1.59 In addition to advisory services, internal auditors provided departments with assurance in the form of audits. We selected three of these audits where we were able to rely on the audit work and its conclusions (see About the Audit for further details). We found that the three departments' internal audit groups were independent and their audits were properly staffed, planned, conducted, and reported. We have incorporated the audit findings and conclusions as part of our own audit work. These internal audits were related most closely to our own objectives and subject matter. They were completed and finalized before the end of our field work and provided a high level of audit assurance.

Reporting to Parliament

1.60 In annual departmental performance reports tabled in Parliament by the President of the Treasury Board, federal government departments are required to report on strategic outcomes and on the results and accomplishments of program activities. The Treasury Board of Canada Secretariat provides guidance to departments on the drafting and production of the departmental performance reports. This annual performance reporting requirement extends to programs under the Economic Action Plan. The first departmental performance reports containing information on the implementation of the Economic Action Plan are expected in fall 2010.

Reports were timely but information on job creation was incomplete

1.61 The amendment to the Budget 2009 motion in the House of Commons required the government to provide additional reports to Parliament that focused on the Economic Action Plan. The motion, as amended, stated that these reports would be tabled quarterly in Parliament during 2009 and would provide information on the Economic Action Plan's implementation, as well as an update on the state of the economy and the actual effects of the Budget with respect to minimizing losses of existing jobs and the creation of job opportunities.

1.62 We examined whether the Economic Action Plan program and financial information collected and reported to Parliament for the programs we audited was timely and provided accurate information on jobs created or maintained as required in the amendment to the Budget motion. We found that the government provided Parliament with updated progress reports on a quarterly basis, focusing on the amount of stimulus funds that were committed once new projects were announced. As well, the government reported a macroeconomic estimate of total jobs created or maintained. However, the information collected from Economic Action Plan programs on jobs could not be collected on a consistent basis. As a result, the information reported to Parliament on project-level jobs was largely anecdotal.

1.63 To support the drafting of the quarterly reports to Parliament, the Treasury Board of Canada Secretariat developed standard templates to capture information on jobs created, spending, and progress information across the various Economic Action Plan programs. The Secretariat consolidated the spending and progress information provided in the templates from departments and forwarded it to the Department of Finance Canada and the Privy Council Office. The Department of Finance Canada was responsible for drafting the quarterly reports while the Privy Council Office had a central responsibility for communications regarding the Economic Action Plan.

1.64 In their reports to the Treasury Board of Canada Secretariat, we found that, for the infrastructure programs we audited, departments used different units of measure and methodologies to estimate the number of jobs created or maintained from the stimulus funding they delivered. For example, some departments described the type of professions employed through Economic Action Plan programs, such as construction trades and manufacturing. Others reported on the number of jobs created and maintained for construction and renovation projects but provided no indication on how the estimates were calculated. In one department, the number of hours worked were calculated and reported. Taken together, estimates of Economic Action Plan-related jobs created or maintained provided by departments to the Treasury Board of Canada Secretariat were not consistent among programs. In order to get more up-to-date information on Economic Action Plan implementation to be included in the quarterly reports, Department of Finance Canada officials went directly to departments for examples of announced or committed projects.

1.65 For example, in the section Building Infrastructure to Create Jobs in each quarterly report, the government described a number of

infrastructure projects funded, the percentage of stimulus funds allocated, and, for some of these projects, the estimated number of jobs created or maintained. The reports do not explain why information was provided for certain projects and not for others. Officials from Department of Finance Canada told us that the examples of project-level jobs described in the quarterly reports were for illustrative purposes only and were intended to complement the macroeconomic analysis. As a result, we found the reports presented an incomplete picture of project-level jobs created or maintained.

1.66 In December 2009, officials from the Department of Finance Canada and Infrastructure Canada told the Standing Committee on Government Operations and Estimates that collecting program information to estimate jobs was not undertaken for all Economic Action Plan programs as the data was considered unreliable. Because of this limitation, the Department of Finance Canada used a macroeconomic model-based analysis to estimate the number of jobs created or maintained. The estimate included all Economic Action Plan programs and the direct and indirect jobs created or maintained. This analysis was reported in Budget 2010, which contained an estimate that the Economic Action Plan created or maintained 130,000 jobs as of January 2010. The Department of Finance Canada has indicated that it will continue to monitor and report on the economic impact of the Economic Action Plan. The methodology used by the Department to develop the macroeconomic analysis of job estimates was beyond the scope of this audit.

1.67 During the first year of the Economic Action Plan, a considerable amount of project-level information related to jobs was collected from departments, some of which was reported to Parliament. We found that the Department of Finance Canada relied on model-based macroeconomic analysis to measure and report on the Economic Action Plan's impact on jobs and the Canadian economy, because project-level job information was unreliable and did not provide a complete picture of jobs created or maintained. Due to the significance of the Economic Action Plan, it is important that departmental performance reports include specific analysis of their individual programs and how these programs contributed to the Economic Action Plan objectives.

1.68 **Recommendation.** The Treasury Board of Canada Secretariat should require departments delivering Economic Action Plan programs to report to Parliament through a separate section of their departmental performance reports on the spending and results of their programs.

The Secretariat's response. Agreed. In May 2010, the Secretariat released guidance to departments that specifically addresses the reporting of Economic Action Plan (EAP) spending and results through the 2009–2010 Departmental Performance Report (DPR). This guidance requires that departments include a summary of their EAP initiatives in Section I and provide details on EAP spending and results in Section II. Guidance to departments on the 2010–2011 DPR will further emphasize the requirement to report on the results of EAP programs.

1.69 **Recommendation.** The Department of Finance Canada and the Privy Council Office should prepare a summary report to Parliament at the conclusion of the Economic Action Plan that includes a detailed account of the Economic Action Plan's impact on the economy.

The entities' response. Generally agreed. The Privy Council Office and the Department of Finance are committed to supporting the government in its reporting on the delivery and economic impact of the Economic Action Plan, building upon the five reports to Canadians that have been provided to date. The Department of Finance is monitoring the impact of the Economic Plan and a final report on the Economic Action Plan will be prepared.

Delivering stimulus quickly

1.70 The fact that design and delivery of the Economic Action Plan were a top priority for senior management helped ensure that departments remained focused on the government's objective to provide stimulus to the economy.

1.71 The decision to use existing programs and delivery mechanisms, where possible, helped accelerate the Economic Action Plan's implementation. Efforts by central agencies to streamline the program review processes were also an important factor in speeding up the overall process.

1.72 Increased and more focused attention to risk by departmental internal audit teams was facilitated through the Office of the Comptroller General working closely with departments.

1.73 Reliance on applicant attestations also helped speed up project review and selection decisions. However, this meant that decisions were made on the basis of limited information. The extent to which this will result in unforeseen consequences, including negative environmental impacts, will not be known until after projects are completed.

1.74 **Recommendation.** The Privy Council Office, the Treasury Board of Canada Secretariat, and the Department of Finance Canada,

considering input from departments delivering Economic Action Plan programs, should assess the practices introduced for the Economic Action Plan and determine which practices could be implemented, where applicable, to provide more timely and efficient processes for the design and delivery of current and future programs and initiatives.

The entities' response. Agreed. The Privy Council Office, the Treasury Board of Canada Secretariat, and the Department of Finance Canada agree to assess the practices introduced for the Economic Action Plan, with input from the departments delivering Economic Action Plan programs, in order to determine which ones could be applied, where applicable, to provide more timely and efficient processes for the design and delivery of similar initiatives.

Conclusion

1.75 The federal budget tabled in January 2009, titled Canada's Economic Action Plan, was designed to respond to a global economic downturn by stimulating the economy, in part by increasing government spending. The Budget initiatives involved about $40 billion in spending, with an additional $12 billion contributed by the provinces and territories. These amounts were subsequently increased to about $47 billion in federal stimulus and $14 billion from provinces and territories. Over 35 federal entities worked to deliver almost 90 programs, including infrastructure programs, in support of the Economic Action Plan.

1.76 From our audit of selected Economic Action Plan programs, we found that the government has adequately managed these selected programs by putting in place appropriate management practices and providing programs to eligible recipients in a timely manner.

1.77 Central agencies and departments took steps to ensure that programs were designed and processes were streamlined to allow for timely implementation of the Economic Action Plan. Central agency review and approval processes were performed more quickly than usual. Mechanisms were developed and adjusted to allow projects to be selected and funds to be allocated quickly.

1.78 The government intended to target Economic Action Plan funding to sectors of the economy and regions of the country in need. We found that, based on the information in applications, all of the projects we audited were in compliance with eligibility criteria as set out in the program terms and conditions. Important considerations for

eligibility were that projects would start quickly and be substantially completed by 31 March 2011. However, we noted that some projects started late, and it is not clear whether they will be completed on time. In addition, due to insufficient information being gathered, it was unclear whether some approved projects needed an environmental assessment.

1.79 We found that central agencies and departments all paid considerable attention to risk. Risks were assessed and controls and mitigation strategies were put in place. Capacity to deliver the Economic Action Plan within the short time frame was a significant risk facing departments, and senior management implemented additional controls to manage this risk. In addition, the Office of the Comptroller General of Canada worked closely with departmental internal audit groups to help address risks. Departmental internal audit functions adjusted their audit plans to focus on areas of greater risk and provided appropriate advice and assurance to management.

1.80 The government met its commitment to provide Parliament with updated progress reports on a quarterly basis. The Department of Finance Canada used a macroeconomic estimate of total jobs created or maintained, as project-level information collected on jobs was unreliable and did not present a complete picture of the impact of jobs from the Economic Action Plan. The Department of Finance Canada has estimated the number of jobs created or maintained as of January 2010 for the Economic Action Plan and has indicated that it will continue to monitor and report on its economic impact.

About the Audit

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by The Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

Objective

To determine whether selected federal entities have adequately managed selected programs for Canada's Economic Action Plan by putting in place appropriate management practices and providing programs to eligible recipients in a timely manner.

Scope and approach

Our audit focused on the design and implementation of the Economic Action Plan by the federal government. We restricted our scope primarily to programs related to infrastructure. The scope includes three primary departments for detailed audit work and/or potential reliance on internal audit: Industry Canada, Infrastructure Canada, and Indian and Northern Affairs Canada. In addition, the following federal departments and agencies are included in our scope for certain aspects of the audit: Agriculture and Agri-Food Canada, Atlantic Canada Opportunities Agency, Canadian Northern Economic Development Agency, Economic Development Agency of Canada for the Regions of Quebec, Federal Economic Development Agency for Southern Ontario, Human Resources and Skills Development Canada, Natural Resources Canada, Public Works and Government Services Canada, Transport Canada, and Western Economic Diversification Canada. The audit also included the role of central agencies (the Privy Council Office, the Treasury Board of Canada Secretariat, and the Department of Finance Canada).

As part of our audit, we incorporated the audit findings and conclusions of three internal audits into our own audit work. We selected these audits because they were related most closely to our own objectives and subject matter. We were able to rely on the audit work performed by departments in compliance with audit standards of The Canadian Institute of Chartered Accountants. The three audits we relied on were:

- The Treasury Board of Canada Secretariat: Audit of the Management of Treasury Board Vote 35
- Human Resources and Skills Development Canada: Audit of Program Eligibility
- Natural Resources Canada: Audit of Accelerated Infrastructure Program

Separate statistically representative random samples were extracted from Economic Action Plan program populations: Building Canada Fund—Communities Component, Community Adjustment Fund, First Nations On-Reserve Housing Program, Infrastructure Stimulus Fund, Investing in Federal Buildings program, Knowledge Infrastructure Program, Marquee Tourism Events Program, and Recreational Infrastructure Canada Program. In all cases, sample sizes were sufficient to allow extrapolation to each program population with a confidence interval of +10 percent and a confidence level of 90 percent.

Two-phase sampling was used for the Investing in Federal Buildings program; that is, one project (related to renovations or improving accessibility) was first sampled within each federal building, and then buildings themselves were sampled.

All projects in the First Nations Schools, and First Nations Water and Wastewater program populations were audited except one school project that was cancelled. All projects in Agriculture and Agri-Food Canada, Natural Resources Canada, and Transport Canada for the Modernizing Federal Laboratories program were audited.

The cut-off dates of projects sampled in the audit were as of the date that the program information was sent to the Treasury Board of Canada Secretariat to be reported in the Government of Canada's Fourth Report to Canadians.

The 10 departments tested for identification of new risks arising from the Economic Action Plan, as mentioned in this chapter, were Agriculture and Agri-Food Canada, Department of Finance Canada, Human Resources and Skills Development Canada, Industry Canada, Infrastructure Canada, Indian and Northern Affairs Canada, Natural Resources Canada, Public Works and Government Services Canada, Transport Canada, and the Treasury Board of Canada Secretariat.

Sample and corresponding population sizes are provided in the following table.

Program	Sample	Population	Sampling strategy
Building Canada Fund—Communities Component	43	645	Simple random
Community Adjustment Fund	51	568	Simple random
First Nations On-Reserve Housing	55	2,804	Simple random
Infrastructure Stimulus Fund	56	3,420	Simple random
Knowledge Infrastructure Program	51	424	Simple random
Marquee Tourism Events Program	33	57	Simple random
Recreational Infrastructure Canada Program	51	1,658	Simple random
First Nations Water and Wastewater Projects	18	18	All
First Nations Schools Projects	12	13	All (Note: one project was cancelled)
Modernizing Federal Laboratories	19	19	Judgemental: Includes all projects for Agriculture and Agri-Food Canada, Natural Resources Canada, and Transport Canada
Investing in Federal Buildings	21	3,390 projects (351 buildings)	Two-phase random
Total	**410**		

Criteria

To determine whether federal entities have appropriate management frameworks for oversight and risk assessment in planning their delivery of the Economic Action Plan, we used the following criteria:

Criteria	Sources
Selected federal entities adequately take into account the risks associated with the implementation of Canada's Economic Action Plan.	Integrated Risk Management Framework, Treasury Board, 2001
The Treasury Board of Canada Secretariat assesses departmental Treasury Board submissions for compliance with pertinent legislation and Treasury Board and departmental policies and authorities, while reflecting assessed risks, sound stewardship, transparency, and accountability.	• Policy on Transfer Payments, sections 6.1, 6.2, 6.4, 6.5.2, 7.2, and 7.3, Treasury Board, 2008 • Policy on Active Monitoring, Treasury Board, 2001

To determine whether federal entities have the necessary controls in place to adequately mitigate the assessed risks, including compliance with federal environmental assessment requirements, we used the following criteria:

Criteria	Sources
Selected federal entities design and implement appropriate control frameworks to mitigate the assessed risks while allowing timely delivery of Economic Action Plan programs to eligible recipients.	• Policy on Active Monitoring, Treasury Board, 2001 • Policy on Internal Control, sections 6.1, 6.2, and 7, Treasury Board, 2009 • Integrated Risk Management Framework, Treasury Board, 2001
Selected federal entities have the necessary controls in place for the Economic Action Plan to adequately mitigate the assessed risks including compliance with federal environmental assessment requirements.	• The Cabinet Directive on the Environmental Assessment of Policy, Plan and Program Proposals, Privy Council Office and the Canadian Environmental Assessment Agency, 2004 • *Canadian Environmental Assessment Act*, 1992

To determine whether selected federal entities provided the Economic Action Plan funds to eligible recipients in a timely manner while respecting relevant authorities and key controls, we used the following criteria:

Criteria	Sources
Selected federal entities that deliver the Economic Action Plan consistently apply clear and well-defined eligibility and selection criteria while respecting authorities and key controls.	• Policy on Transfer Payments, sections 3.6, 3.7, and 5.2, Treasury Board, 2008 • Directive on Transfer Payments, section 5.1 and appendices B, E, and G, Treasury Board, 2008 • Policy on Internal Control, sections 3.1 and 5.2, Treasury Board, 2009 • Contracting Policy, section 2, Treasury Board, 2001
Selected federal entities approve and manage selected Economic Action Plan programs to eligible recipients in a timely manner.	Budget 2009, Chapter 3 "Overview," p. 68

To determine whether selected federal entities have adequate processes in place to monitor and report on Economic Action Plan progress and performance, we used the following criteria:

Criteria	Sources
Selected federal entities have adequate processes in place to monitor and collect timely, accurate, and complete information on their progress toward Economic Action Plan implementation and to take corrective action when necessary.	• Policy on Transfer Payments, sections 6.5.2 to 6.5.5 and section 6.6.1, Treasury Board, 2008 • Policy on Active Monitoring, Treasury Board, 2001
Program and financial information on the status of selected Economic Action Plan program implementation, approval, and delivery is timely, accurate, and complete and is relevant to the analysis of the objectives of the Economic Action Plan.	• Policy on Management, Resources and Results Structures, sections 5.1 to 5.2.3, Treasury Board, 2010 • Policy on Transfer Payments, sections 6.5.2 to 6.5.5, Treasury Board, 2008

To determine whether Internal Audit of selected federal entities implementing Canada's Economic Action Plan have provided appropriate advice and assurance to management that internal controls and management practices are adequate for the management of expenditures under the Economic Action Plan, we used the following criteria:	
Criteria	**Sources**
The risk-based audit plans of selected federal entities consider and assess key elements of the Economic Action Plan.	• Directive on Chief Audit Executives, Internal Audit Plans, and Support to the Comptroller General, Treasury Board, 2009 • Principles for Internal Audit: Budget 2009, Office of the Comptroller General • The Institute of Internal Auditors
The internal audit function of selected federal entities provides management with an appropriate level of assurance on the effectiveness of the management control framework that is in place to address the risks associated with implementing Canada's Economic Action Plan.	• Policy on Internal Audit, Treasury Board, 2009 • The Institute of Internal Auditors
The internal audit function of selected federal departments provides adequate advisory services to senior management on addressing the risks associated with implementing the Economic Action Plan.	• Principles for Internal Audit: Budget 2009, Office of the Comptroller General • Policy on Internal Audit, Treasury Board, 2009
Where we intend to rely on the work of internal auditors of selected federal entities, their work meets the standards of the Institute of Internal Auditors and the Internal Auditing Standards for the Government of Canada.	• The Canadian Institute of Chartered Accounts auditing standards, section 5050.10 (a)—Using the Work of Internal Audit • Policy on Internal Audit, Treasury Board, 2009 • Directive on Chief Audit Executives, Internal Audit Plans, and Support to the Comptroller General, Treasury Board, 2009 • Directive on Departmental Audit Committees, Treasury Board, 2009 • The Institute of Internal Auditors

Management reviewed and accepted the suitability of the criteria used in the audit.

Period covered by the audit

Audit work for this chapter was substantially completed on 27 April 2010.

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Appendix A Description of programs audited

Program name	Building Canada Fund—Communities Component
Departments responsible for program delivery	Lead department: Infrastructure Canada Delivery agents: • Atlantic Canada Opportunities Agency • Canadian Northern Economic Development Agency • Economic Development Agency of Canada for the Regions of Quebec • Federal Economic Development Agency for Southern Ontario • Western Economic Diversification Canada
Total allocation (from Budget 2009)	$500 million over two years
Number of applications received and approved at the time of our audit	Received: 2,802 Approved: 537
Program eligibility criteria (in addition to project completion required by 31 March 2011)	• Project must be in a community with a population of 100,000 or less. • The existing Communities Component allocation for a province had to be fully committed to projects before municipalities in that province could access the additional funding under the Economic Action Plan.
Eligible projects	• Connectivity and broadband • Contaminated area redevelopment • Core national highway system • Disaster mitigation • Drinking water • Green energy • Local and regional airports • Public transit • Recreation • Roads and bridges • Short-line railways • Short-sea shipping • Solid waste management • Sports and culture • Tourism • Wastewater infrastructure

<table>
<tr><th>Program name</th><td colspan="3">Community Adjustment Fund (CAF)</td></tr>
<tr><th>Agencies responsible for program delivery</th><td colspan="3">• Atlantic Canada Opportunities Agency (ACOA)
• Canadian Northern Economic Development Agency (CanNor)
• Economic Development Agency of Canada for the Regions of Quebec (CED-Q)
• Federal Economic Development Agency for Southern Ontario (FedDev)
• Federal Economic Development Initiative in Northern Ontario (FedNor)
• Western Economic Diversification Canada (WD)</td></tr>
<tr><th>Total allocation (from Budget 2009)</th><td colspan="3">$1 billion over 2 years</td></tr>
<tr><th>Number of applications received and approved at the time of our audit</th><td colspan="3"><table>
<tr><th>Entity</th><th>Applications received</th><th>Applications approved</th></tr>
<tr><td>ACOA</td><td>275</td><td>165</td></tr>
<tr><td>CanNor</td><td>19</td><td>6</td></tr>
<tr><td>CED-Q</td><td>293</td><td>197</td></tr>
<tr><td>FedDev</td><td>597</td><td>91</td></tr>
<tr><td>FedNor</td><td>234</td><td>55</td></tr>
<tr><td>WD</td><td>1,101</td><td>286</td></tr>
<tr><td>TOTAL</td><td>2,519</td><td>800</td></tr>
</table></td></tr>
<tr><th>Program eligibility criteria (in addition to project completion required by 31 March 2011)</th><td colspan="3">• Projects must be incremental (CAF funding cannot replace other funding already available).
• Funding is available to communities with a population of 250,000 or less that have experienced major layoffs and
  • where there is a lack of alternative job opportunities
  OR
  • where the year-over-year increase in Employment Insurance claimants is equal to or greater than 20 percent.
• Projects eligible under other infrastructure programs are not considered eligible for CAF funding.</td></tr>
<tr><th>Eligible projects</th><td colspan="3">Eligible projects varied by region and regional development agency (such as a category for forestry in British Columbia and lobster fishing in Atlantic Canada and Quebec). The projects should
• generate immediate employment;
• create the most near-term employment per dollar of federal investment;
• leverage funds from the province or territory and other funding partners;
• build on collaboration agreements already in place (e.g., federal-provincial agreements and existing programs); and
• provide a legacy of longer-term ecological and/or economic benefits.</td></tr>
</table>

Program name	**First Nations On-Reserve Housing**
Department responsible for program delivery	Indian and Northern Affairs Canada
Total allocation (from Budget 2009)	$150 million over two years (This does not include $250 million over two years for First Nations housing being delivered by the Canada Mortgage and Housing Corporation.)
Number of applications received and approved at the time of our audit	Received: 11,647 Approved: 2,756
Program eligibility criteria (in addition to project completion required by 31 March 2011)	• On-reserve housing • Community housing plans • Job creation, contracting, and/or subcontracting opportunities
Eligible projects	• Construction of multi-unit housing • Lot servicing • Renovations • Transition of band-owned units to market-based housing

Program names	**First Nations Schools** **First Nations Water and Wastewater Projects**
Department responsible for program delivery	Indian and Northern Affairs Canada
Total allocation (from Budget 2009)	$365 million over two years The total allocation to water and wastewater projects was increased from $165 million to $179 million and was offset by a reduction in the allocation for school projects.
Number of projects pre-selected	13 schools (1 project was subsequently cancelled) and 18 water and wastewater projects
Program eligibility criteria (in addition to project completion required by 31 March 2011)	N/A—Projects were pre-selected for funding under Budget 2009.
Eligible projects	Projects must be ready to begin construction immediately and be completed by 31 March 2011.

Program name	**Infrastructure Stimulus Fund**
Department responsible for program delivery	Infrastructure Canada
Total allocation (from Budget 2009)	$4 billion over two years
Number of applications received and approved at the time of our audit	Received: 7,244 Approved: 4,015
Program eligibility criteria	Incrementality of the project, that the construction activity would not otherwise have been constructed by 31 March 2011, project readiness, and merit.
Eligible projects	**Provincial/territorial assets** • Highway infrastructure • Local road infrastructure • Regional transit infrastructure • Disaster mitigation infrastructure • Contaminated area redevelopment infrastructure • Cultural infrastructure • Port and cruiseship infrastructure • Parks and trails **Local government assets** • Water and wastewater infrastructure • Public transit infrastructure • Local road infrastructure • Disaster mitigation infrastructure • Solid waste management infrastructure • Contaminated area redevelopment infrastructure • Cultural infrastructure • Airport infrastructure • Port and cruiseship infrastructure • Municipal buildings • Parks and trails **Not-for-profit sector assets** • Temporary housing shelters • Community centres and community services infrastructure • Contaminated area redevelopment infrastructure • Cultural infrastructure • Port and cruiseship infrastructure **Private sector assets** • Short-line rail infrastructure • Port and cruiseship infrastructure

Program name	Marquee Tourism Events Program
Department responsible for program delivery	Industry Canada
Total allocation (from Budget 2009)	$100 million over two years
Number of applications received and approved at the time of our audit	Received: 165 Approved: 60
Program eligibility criteria (in addition to project completion required by 31 March 2011)	**Summer 2009 Marquee Tourism Event Stream** • Event must commence between 1 April 2009 and 30 September 2009. • Event must, at a minimum, meet the eligibility criteria for Tier 2 projects (see below) plus • current and potential impact on tourism-related spending in Canada, • current and potential impact in promoting Canada as premier international tourism destination, and • regional representation. **Tier 1 Projects:** • 250,000: minimum overall attendance • 10 percent: minimum percentage of attendees that are tourists • $2 million: minimum cash operating budget • minimum 3 years: number of years event/organization has been in existence • minimum 3 consecutive days of programming: number of consecutive days of programming • must have an existing international marketing strategy that incorporates overnight tour packages **Tier 2 Projects:** • 50,000: minimum overall attendance • 10 percent: minimum percentage of attendees that are tourists • $500,000: minimum cash operating budget • minimum 3 years: number of years event/organization has been in existence • minimum 3 consecutive days of programming: minimum number of consecutive days of programming • must have an existing domestic marketing strategy and an existing or proposed international marketing strategy that would incorporate overnight tour packages
Eligible projects	Annual recurring world-class events that are well established and have a long tradition of programming and management excellence

Program name	Knowledge Infrastructure Program
Department responsible for program delivery	Industry Canada
Total allocation (from Budget 2009)	$2 billion
Number of applications received and approved at the time of our audit	Received: 944 Approved: 536
Program eligibility criteria (in addition to project completion required by 31 March 2011)	Open to all post-secondary public and not-for-profit private institutions, including Aboriginal-controlled and Government of Canada-controlled post-secondary institutions.
Eligible projects	Deferred maintenance, repair, and expansion projects at post-secondary institutions that improve the quality of research and development and the ability to deliver advanced knowledge and skills training.

Program name	Recreational Infrastructure Canada (RInC) Program
Departments responsible for program delivery	Atlantic Canada Opportunities Agency Canadian Northern Economic Development Agency Economic Development Agency of Canada for the Regions of Quebec Federal Economic Development Agency for Southern Ontario Western Economic Diversification Canada
Total allocation (from Budget 2009)	$500 million over two years
Number of applications received and approved at the time of our audit	Received: 3,764 Approved: 1,939
Program eligibility criteria (in addition to construction being materially completed by 31 March 2011)	Projects must • fall under one of the eligible project categories; • rehabilitate or repair recreational facilities, including new construction that is either adding to or replacing existing recreational infrastructure assets or capacity; and • be incremental; that is, projects would not have occurred, as proposed, without support from RInC.
Eligible projects	• Arenas • Gymnasiums • Swimming pools • Sports fields • Tennis, basketball, volleyball, or other sport-specific courts • Parks, fitness trails, and bike paths • Other multi-purpose physical recreation facilities

Program name	Investing in Federal Buildings
Primary department responsible for program delivery	Public Works and Government Services Canada
Total allocation (from Budget 2009)	$264 million over two years for eligible projects listed below
Number of applications received and approved at the time of our audit	Funds were used to accelerate already approved projects (therefore applications were not submitted for this program). Number of projects approved: 1,623
Program eligibility criteria (in addition to project completion required by 31 March 2011)	• Eligible projects are identified through the National Investment Strategy (supported by building management plans and asset management plans). • All ongoing program funding must be spent before funds from the Economic Action Plan can be accessed.
Eligible projects (within the scope of our audit)	• Building repairs and renovations • Enhanced accessibility • Contaminated sites • Federal bridges • Manège Militaire

Program name	Modernizing Federal Laboratories
Department responsible for program delivery	The Treasury Board of Canada Secretariat managed the selection process; Treasury Board allocated amounts to custodial departments for projects that in many cases were delivered by Public Works and Government Services Canada.
Total allocation (from Budget 2009)	$250 million over two years
Number of applications received and approved at the time of our audit	Received: 116 Approved: 89
Program eligibility criteria (in addition to project completion required by 31 March 2011)	Federal laboratories that • contribute to core federal regulatory responsibilities, • advance science and technology capacity, and • contribute to enhancing the health and safety of Canadians.
Eligible projects	• Projects must address maintenance issues in federal laboratories. • Laboratories must contribute to core federal regulatory responsibilities, advance science and technology capacity, and/or contribute to enhancing the health and safety of Canadians. • Projects must provide economic stimulus.

Appendix B List of recommendations

The following is a list of recommendations found in Chapter 1. The number in front of the recommendation indicates the paragraph where it appears in the chapter. The numbers in parentheses indicate the paragraphs where the topic is discussed.

Recommendation	Response
Reporting to Parliament	
1.68 The Treasury Board of Canada Secretariat should require departments delivering Economic Action Plan programs to report to Parliament through a separate section of their departmental performance reports on the spending and results of their programs. **(1.61–1.67)**	**The Secretariat's response.** Agreed. In May 2010, the Secretariat released guidance to departments that specifically addresses the reporting of Economic Action Plan (EAP) spending and results through the 2009–2010 Departmental Performance Report (DPR). This guidance requires that departments include a summary of their EAP initiatives in Section I and provide details on EAP spending and results in Section II. Guidance to departments on the 2010–2011 DPR will further emphasize the requirement to report on the results of EAP programs.
1.69 The Department of Finance Canada and the Privy Council Office should prepare a summary report to Parliament at the conclusion of the Economic Action Plan that includes a detailed account of the Economic Action Plan's impact on the economy. **(1.61–1.67)**	**The entities' response.** Generally agreed. The Privy Council Office and the Department of Finance are committed to supporting the government in its reporting on the delivery and economic impact of the Economic Action Plan, building upon the five reports to Canadians that have been provided to date. The Department of Finance is monitoring the impact of the Economic Plan and a final report on the Economic Action Plan will be prepared.

Recommendation	Response
Delivering stimulus quickly	
1.74 The Privy Council Office, the Treasury Board of Canada Secretariat, and the Department of Finance Canada, considering input from departments delivering Economic Action Plan programs, should assess the practices introduced for the Economic Action Plan and determine which practices could be implemented, where applicable, to provide more timely and efficient processes for the design and delivery of current and future programs and initiatives. **(1.8–1.73)**	**The entities' response.** Agreed. The Privy Council Office, the Treasury Board of Canada Secretariat, and the Department of Finance Canada agree to assess the practices introduced for the Economic Action Plan, with input from the departments delivering Economic Action Plan programs, in order to determine which ones could be applied, where applicable, to provide more timely and efficient processes for the design and delivery of similar initiatives.

Report of the Auditor General of Canada to the House of Commons—Fall 2010

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2010



FALL

Report of the

Auditor General of Canada

to the House of Commons

Chapter 2

Management and Control in Small Entities

Office of the Auditor General of Canada



2010



Report of the

Auditor General of Canada

to the House of Commons

FALL

Chapter 2

Management and Control in Small Entities

Office of the Auditor General of Canada

The Fall 2010 Report of the Auditor General of Canada comprises Matters of Special Importance, Main Points—Chapters 1 to 9, Appendices, and nine chapters. The main table of contents for the Report is found at the end of this publication.

The Report is available on our website at www.oag-bvg.gc.ca.

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Chapter

2

Management and Control in Small Entities

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Management and Control in Small Entities

Main Points

What we examined

The federal government includes a large number of small agencies, boards, and commissions that carry out a wide range of activities, from environmental assessment to transportation safety. Most of these organizations, generally known as "small entities," have investigatory, regulatory, or quasi-judicial functions. For this audit of management and control practices, we considered small entities to be federal organizations that either have operating budgets of less than $300 million a year or have fewer than 500 employees.

Our audit examined three small entities:

- The Canadian Forces Housing Agency, a special operating agency within National Defence. It operates, maintains, and allocates roughly 14,000 housing units across Canada on the Department's behalf.
- The Canadian Pari-Mutuel Agency, a special operating agency within Agriculture and Agri-Food Canada. The Agency regulates and supervises pari-mutuel betting on horse races to ensure that betting is fair to the public.
- The Pension Appeals Board, an administrative tribunal that is responsible for hearing appeals of Canada Pension Plan applicants that arise from decisions of the Office of the Commissioner of Review Tribunals. Although the Board is an administrative part of Human Resources and Skills Development Canada, it is independent of that department in its quasi-judicial role.

We looked at the controls applied by the three entities for acquisition cards, contracting, executive travel, hospitality, and selected areas of human resource management. We also examined whether the entities' management and control practices comply with government policies.

Audit work for this chapter was substantially completed on 16 March 2010.

This was the third audit of small entities reported by this Office; our previous audits looked at management and control, and at governance arrangements.

Why it's important

The relatively small federal organizations defined as small entities can have a significant impact on the health, safety, and quality of life of Canadians; on recourse for public servants or for citizens in cases of perceived unfairness and inequity; and on the competitiveness of Canadian industry. Some settle claims or arbitrate disputes that involve the government as an interested party, and they must therefore be independent from the government in such matters. As publicly funded bodies within the government, they need to ensure prudence, probity, and effective control over the spending of public funds.

What we found

- All three entities have management controls in place that are consistent with Treasury Board requirements and that are applied in managing the use of acquisition cards, contracting, executive travel, and hospitality.
- The Canadian Forces Housing Agency and the Pension Appeals Board have well defined human resource plans that are based on their operational needs. These plans identify future needs and challenges and are supported by strategies and initiatives. At the time of our audit, the Canadian Pari-Mutuel Agency was working on a draft human resource plan that had yet to be approved.
- All three entities have performance management systems in place and manage executive compensation in compliance with relevant authorities, although documentation of performance agreements and appraisals could be improved.

The entities have responded. The entities agree with the recommendation. Their detailed responses follow the recommendation in the chapter.

Introduction

2.1 There is a large number of small agencies, boards, and commissions in the federal government performing a wide range of activities, from environmental assessment to transportation safety. Most of these organizations, commonly referred to as small entities, have investigatory, regulatory, or quasi-judicial functions. While the government defines small entities in a number of ways, for this audit, we considered them to be organizations that have either an annual operating budget of less than $300 million or fewer than 500 employees.

2.2 Despite their relatively small size, these organizations can have a significant impact on the health, safety, and quality of life of Canadians; on public servants' or citizens' recourse in case of perceived unfairness and inequity; and on the competitiveness of Canadian industry.

2.3 Small entities with quasi-judicial or ombudsman-type roles settle claims or arbitrate disputes that may involve government as an interested party. Thus, it is important that they be independent from government in the exercise of their mandate, even though they are publicly funded bodies within the public service. They nevertheless need to ensure prudence, probity, and effective control over the spending of public funds.

Challenges and risks facing small entities

2.4 Most small entities within the federal government are subject to the management and control requirements of the *Financial Administration Act* (FAA) and to various Treasury Board policies, directives, and government regulations (referred to as relevant Treasury Board authorities in this chapter). Relevant sections of the FAA are outlined in Exhibit 2.1.

2.5 A couple of key features common to most small entities are informal structures—for example, ad hoc reviews (as opposed to a formal committee and governance mechanisms), and staff with multiple responsibilities (as opposed to the separation of roles and responsibilities normally found in large organizations).

2.6 To maintain the public's trust and confidence in government, deputy heads and senior management of government organizations are required to discharge their responsibilities according to the highest ethical standards of integrity, objectivity, and impartiality. Their conduct and actions are expected to exemplify the values of the

public service. Appropriate comptrollership and management are essential in any federal organization to manage financial risks and protect against fraud, financial negligence, violation of financial rules or principles, and loss of assets or public money.

Exhibit 2.1 ***Financial Administration Act*** **provisions serve as key controls over procuring, verifying, and paying for goods and services**

The *Financial Administration Act* (FAA) is the cornerstone of the legal framework for general financial management and accountability of public service organizations. The FAA requires that fundamental controls for procuring and paying for goods and services be respected.

The processes of procuring, verifying, and paying for a purchase involve applying sections 32, 34, and 33 of the FAA. These three sections require

- that funds be available and committed for the purchase (section 32);
- that these goods or services be performed, supplied, or rendered, and the price be as previously stated—verification—and that the person with delegated financial authority signs that the verification has been completed—certification—(section 34); and
- that no payment for a purchase be made unless it has been properly requisitioned (section 33).

Source: Adapted from the *Financial Administration Act*

Previous audit work

2.7 The Office of the Auditor General of Canada previously conducted two other audits on small entities. In our October 2007 Report, Chapter 2, Management and Control Practices in Three Small Entities, we reported that all three entities audited had effective management control procedures in place for managing the use of acquisition cards, executive travel, and hospitality. It also noted some areas for improvement in contracting, human resource planning, executive performance pay, and labour relations. In our December 2008 Report, Chapter 2, Governance of Small Federal Entities, we reported that some key elements of the governance regime, including mechanisms for oversight and coordination, were not working well. In addition, central agencies (the Treasury Board and Privy Council Office) had not adequately developed an approach to reduce the reporting burden or to make it easier to share administrative services.

Entities selected for examination

2.8 In this audit, we examined the Canadian Forces Housing Agency, the Canadian Pari-Mutuel Agency, and the Pension Appeals Board. Exhibit 2.2 includes a brief description of each entity. The three entities are subject to a certain level of departmental oversight.

Exhibit 2.2 Small entities selected for the audit

Name and description of the entity	Number of full-time equivalents	Budget (in millions) 2008–09
Canadian Forces Housing Agency	305	$117.1
The Canadian Forces Housing Agency is a **special operating agency** of National Defence. The Agency's employees are public servants and are accountable to the Department. The Agency is the managing authority for the Department housing portfolio. It operates, maintains, and allocates approximately 14,000 residential housing units at 32 sites across Canada.		
The Canadian Forces Housing Agency's duties include the allocation, maintenance, repair, and recapitalization of the housing units; the administration of the shelter charge system (rents for housing units); and the strategic management of the housing assets on behalf of the Department.		
Canadian Pari-Mutuel Agency	56	$13.8
The Canadian Pari-Mutuel Agency is a special operating agency within Agriculture and Agri-Food Canada that regulates and supervises pari-mutuel betting on horse racing at racetracks across Canada, thereby ensuring that **pari-mutuel betting** is conducted in a way that is fair to the public. The Agency's employees are public servants and are accountable to the Department. Canadian Pari-Mutuel Agency officers are responsible for the supervision of pari-mutuel betting. They • test and monitor all computerized **betting tote systems**; • audit the distribution of payout prices; • conduct investigations into questionable activities in pari-mutuel betting; • enforce all betting regulations and policies; • ensure compliance; and • monitor and administer race surveillance. The Agency also administers the Equine Drug Control Program.		

Special operating agency—An agency within a government department that has greater management flexibility in return for certain levels of performance and results.

Pari-mutuel betting—A betting system in which all bets of a particular type are combined, and winning bets are allocated a proportionate share of the losing bets minus legal deductions.

Betting tote system—The equipment and software that are used to transmit and record betting data, to cash and sell bets, and to display and calculate odds and payouts.

Exhibit 2.2 Small entities selected for the audit (continued)

Name and description of the entity	Number of full-time equivalents	Budget (in millions) 2008–09
Pension Appeals Board	30	$4.0
The Pension Appeals Board is an independent administrative tribunal established under the Canada Pension Plan. It is the third level of appeal for Canada Pension Plan applicants. The Pension Appeals Board is responsible for hearing appeals that arise from the decisions of the Office of the Commissioner of Review Tribunals. The Pension Appeals Board is independent from Human Resources and Skills Development Canada in its quasi-judicial role. However, the Deputy Minister of Human Resources and Skills Development is the Accounting Officer for the whole Department, which includes the Pension Appeals Board. Members of the Pension Appeals Board are federal or provincial superior court judges or former judges and are appointed by the **Governor in Council**. Members include a Chairman, Vice-Chairman, and up to 10 permanent members and additional temporary Members. Hearings are held in major cities across Canada and are open to the public. In matters of financial administration, the Pension Appeals Board is expected to follow the Department's rules.		

Source: Canadian Forces Housing Agency; Canadian Pari-Mutuel Agency, and Pension Appeals Board

Governor in Council—The Governor General acting on the advice of the Privy Council, as the formal executive body that gives legal effect to those decisions of Cabinet that are to have the force of law.

Focus of the audit

2.9 In each of the three selected small entities, we looked at management control procedures for acquisition cards, contracting, executive travel, and hospitality. The aspects of human resource management we looked at were planning, performance management, and executive compensation. We consider these areas to be important given that entities have to ensure prudence, probity, and effective control over the spending of public funds. More details on the audit objectives, scope, approach, and criteria are in **About the Audit** at the end of this chapter.

Observations and Recommendation

Acquisition cards, contracting, executive travel, and hospitality

2.10 We reviewed key policies in selected entities to determine whether they were consistent with the relevant Treasury Board authorities on acquisition cards, travel, contracting, and hospitality. We also selected controls based on the *Financial Administration Act* and the relevant Treasury Board authorities, and examined whether the entities had applied them properly in the four audited areas. We reviewed a statistically representative sample of acquisition card transactions, executive travel claims, and hospitality events and a random sample of contracts in selected entities.

Policies and controls are adequate

2.11 We found that all three entities were following policies consistent with the key requirements of the relevant Treasury Board authorities.

2.12 We also found that for the management of acquisition cards, executive travel expenses, and hospitality expenses, and for the awarding and administration of the contracts we examined, each entity had effective control procedures and had applied them as required. These procedures included

- properly authorizing transactions,
- certifying transactions under the *Financial Administration Act*,
- documenting transactions accurately and properly, and
- ensuring that transactions were business related.

2.13 **Acquisition cards.** Acquisition cards are credit cards used by federal departments and agencies to purchase and pay for goods and services. Departments and agencies are required to ensure compliance with the Treasury Board Directive on Acquisition Cards to establish management practices and controls that ensure the economical, efficient, and secure use of acquisition cards. Compliance with this directive also allows departments and agencies to manage the risk of cards being misused or abused by those who have access to this method of paying for goods and services.

2.14 Exhibit 2.3 provides information on the acquisition card transactions in each entity between 1 April 2008 and 31 March 2009.

Exhibit 2.3 Acquisition card transactions in the 2008–09 fiscal year

Entity	Total number of transactions	Total value	Number of cards in circulation
Canadian Forces Housing Agency	2,526	$418,900	65
Canadian Pari-Mutuel Agency	59	$14,300	2
Pension Appeals Board	198	$99,200	2

Total values have been rounded.

Source: Data provided by the entities

2.15 Contracting. The objective of contracting in the government is to acquire goods and services in a manner that enhances access, competition, and fairness and that results in the best value or, if appropriate, the optimal balance of overall benefits to the Crown and the Canadian people. The Treasury Board's Contracting Policy is a formal management and control framework that applies to all federal departments and agencies.

2.16 Exhibit 2.4 provides information on the contracts initiated in each entity between 1 April 2008 and 31 March 2009.

Exhibit 2.4 Contracts initiated in the 2008–09 fiscal year

Entity	Total number of contracts	Total value of contracts
Canadian Forces Housing Agency	75,686	$84,415,300
Canadian Pari-Mutuel Agency	19	$923,200
Pension Appeals Board	58	$494,400

Total values have been rounded.

Source: Data provided by the entities

2.17 Executive travel. Federal public servants are often required to travel to carry out their duties. The Treasury Board has issued the Travel Directive and the Special Travel Authorities to govern the management and control of travel in the federal government. The purpose of the Travel Directive is to ensure fair treatment of employees required to travel on government business. Its provisions constitute mandatory requirements for public service employees and the reimbursement of reasonable travel expenses necessarily incurred while travelling on government business. The Special Travel Authorities policy applies to travel of deputy heads, Governor-in-Council appointees, and executives.

2.18 Exhibit 2.5 provides information on the executive travel expenses in each entity between 1 April 2008 and 31 March 2009.

Exhibit 2.5 Executive travel expenses in the 2008–09 fiscal year

Entity	Total number of executive travel claims	Total value of executive travel expenses
Canadian Forces Housing Agency	29	$12,100
Canadian Pari-Mutuel Agency	16	$9,000
Pension Appeals Board	235	$813,200

Total values have been rounded.

Source: Data provided by the entities

Hospitality—As defined by the Treasury Board, consists of breakfast, lunch, dinner, receptions, refreshments, or beverages (with or without food). Official hospitality may exceptionally consist of tickets to theatre or sporting events, tours of the National Capital Region or other places of interest, local transportation to and from a function, room rental, and incidentals such as flowers.

2.19 **Hospitality.** It is government policy to extend hospitality in an economical, consistent, and appropriate way when it will facilitate government business or is considered desirable as a matter of courtesy. To ensure that economy and consistency in offering hospitality are maintained throughout the federal public service, the Treasury Board has issued the Hospitality Policy, which applies to departments and agencies, including the three audited entities.

2.20 Exhibit 2.6 provides information on the hospitality expenses in each entity between 1 April 2008 and 31 March 2009.

Exhibit 2.6 Hospitality expenses in the 2008–09 fiscal year

Entity	Total number of hospitality events	Total value of hospitality expenses
Canadian Forces Housing Agency	9	$4,100
Canadian Pari-Mutuel Agency	6	$2,300
Pension Appeals Board	35	$20,100

Total values have been rounded.

Source: Data provided by the entities

Human resource management

2.21 Human resource management is the integrated use of systems, policies, and management practices to recruit, develop, and retain employees who can help the organization meet its goals. Effective human resource management plays an important role in assuring employee satisfaction and improving performance and productivity.

2.22 Our audit looked at three important areas of human resource management for the entities:

- human resource planning,
- performance management systems, and
- executive compensation.

Sound human resource management practices are in place

2.23 **Human resource planning.** Human resource planning includes identifying the human resources an organization needs currently and will need in the future to achieve its operational goals. Based on existing guidance provided by the Treasury Board of Canada Secretariat, an adequate planning process identifies an organization's human resource needs in a way that is consistent with its operational requirements.

2.24 We found that the Canadian Forces Housing Agency (CFHA) and the Pension Appeals Board (PAB) had well-defined human resource plans, which were based on their operational needs. These plans identified future needs and challenges and were supported by strategies and initiatives. While the Canadian Pari-Mutuel Agency (CPMA) is referred to in Agriculture and Agri-Food Canada's department-wide human resource plan, we found that the Agency was working on its own draft human resource plan, which had yet to be approved. The draft plan identified gaps in needed skills, but CPMA had not yet recommended strategies to address them.

2.25 **Performance management systems.** A good performance management system comprises a set of practices to define, review, and reward work and to develop employee competencies. It includes communication between supervisors and employees about job performance, promotions, training and development, and career aspirations. At the heart of that system is the employee appraisal process, which includes setting concrete objectives for the coming year and evaluating the previous year's performance.

2.26 We found that all three entities had performance management systems in place to monitor their employees' performance. CFHA and PAB properly completed annual performance appraisals for employees, which included the identification of learning and training needs.

2.27 Although CPMA had a performance management system in place, we noted that the completion of employees' appraisals could be improved. CPMA follows its parent department's policy—Agriculture

and Agri-Food Canada's Employee Performance Management Program Policy. This policy states that the process surrounding the completion of performance appraisals is intended to strengthen the links between departmental priorities, outcome projects, work objectives, results achieved, competencies, and learning. Files we reviewed were incomplete in one or more areas, such as objectives, performance measures related to objectives, narrative describing the employee's performance, or performance ratings. We also found that CPMA is not carrying out appraisals for its part-time employees, who make up more than 36 percent of its permanent workforce. The Agency acknowledges the importance of carrying out these appraisals and is currently implementing procedures to ensure that appraisals for all employees are properly completed.

2.28 **Executive compensation.** Executive compensation consists of both salary and non-salary elements. The salary element includes base salary and performance pay, and non-salary compensation includes various types of benefits. A sound performance pay process contributes to an organization's ability to focus on common corporate objectives by sending clear signals about the accountability of executives and the importance placed on results. As outlined in the Treasury Board Directive and guidelines on the Performance Management Program for Executives, a valid performance agreement specifies

- the period covered by the agreement,
- performance measures (commitments) and related results achieved,
- a summary rating of performance,
- a narrative assessment of performance, and
- the signatures of the reviewing manager and the employee.

2.29 We found that annual salaries paid to executives, per diem paid to Governor-in-Council appointees, and non-salary compensation in the three entities were managed in compliance with relevant authorities. We also found that ongoing and key commitments for executives were included in performance agreements, updated regularly, and aligned with organizational goals. In our view, all three entities' processes for awarding and authorizing performance pay were correctly carried out, but performance agreement and appraisal forms for executives were not always consistently completed. In all entities, we found two or more of the following issues: missing signatures in some agreements or appraisals and the absence of performance ratings.

2.30 Recommendation. The Canadian Forces Housing Agency, the Canadian Pari-Mutuel Agency, and the Pension Appeals Board should ensure that performance agreement and appraisal forms for executives are consistently completed and documented in accordance with the requirements of the Treasury Board Directive and guidelines on the Performance Management Program for Executives.

The Canadian Forces Housing Agency's response. Agreed. For the current year's Performance Management Program for Executives process, the directorate responsible for civilian executive services within National Defence will ensure that comprehensive file records are maintained of all completed performance assessments for National Defence executive employees, including the Canadian Forces Housing Agency executives. The Agency will continue to ensure that performance agreements and assessments are prepared in accordance with the Treasury Board of Canada Secretariat's direction and National Defence guidelines.

The Canadian Pari-Mutuel Agency's response. Agreed. The Canadian Pari-Mutuel Agency is part of Agriculture and Agri-Food Canada's performance management process for the executive group. The Department will review its current process for obtaining both the employee and the manager's signatures and make the appropriate adjustments by 30 September 2010.

The Pension Appeals Board's response. Agreed. Effective immediately, the Pension Appeals Board and Human Resources and Skills Development Canada will ensure that performance agreements for executives at the Pension Appeals Board are duly signed.

Conclusion

2.31 Overall, we found that, for the management of acquisition cards, executive travel expenses, and hospitality expenses, and for the awarding and administration of the contracts we examined, each entity had effective control procedures and had applied them as required. We also found that they had sound human resource management practices in the areas we examined. However, we noted that documentation of performance agreements and appraisals could be improved.

About the Audit

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by The Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

Objectives

The objective of our audit was to determine whether the small entities had effective management control procedures in place for acquisition cards, contracting, executive travel, and hospitality and whether they had sound human resource management practices for selected areas of human resources.

We define effective management controls as compliance with applicable authorities in the areas of acquisition cards, contracting, executive travel, and hospitality.

We define sound human resource management practices as compliance with applicable authorities in the selected areas of human resources (human resource planning, performance management system, and executive compensation).

Scope and approach

We selected three entities for our audit: the Canadian Forces Housing Agency (CFHA), the Canadian Pari-Mutuel Agency (CPMA), and the Pension Appeals Board (PAB). These agencies represent a cross-section of small entities within the federal government, in terms of size and range of functions. The audit looked at activities from 1 April 2008 to 31 March 2009. It did not cover the programs provided by the entities.

Our audit approach included auditing management and control practices in the following areas: acquisition cards, contracting, executive travel, hospitality, and selected areas of human resource management. We consider those areas to be important, given that entities have to ensure prudence, probity, and effective control over the spending of public funds. Our approach included analyzing policies and guidelines, examining files, and interviewing representatives from the audited entities.

Separate, statistically representative samples of transactions completed in the 2008–09 fiscal year were randomly selected for acquisition cards, executive travel, and hospitality for each of the entities examined. Sample sizes were sufficient to project to each sampled population with a confidence level of 90 percent and a confidence interval of plus 10 percent.

For contracts, non-statistical selections were made for each of the three entities by randomly selecting contracts initiated in the 2008–09 fiscal year. High-value and randomly selected contracts were extracted from each contract population. The sample sizes were 21 contracts at CFHA, 10 contracts at CPMA, and 10 contracts at PAB.

Criteria

To determine whether the small entities had effective management control procedures in place for acquisition cards, contracting, and executive travel, we used the following criteria:	
Criteria	**Sources**
The selected small entities have effective controls for the management and the use of acquisition cards that are consistent with relevant authorities.	• *Financial Administration Act* • Directive on Acquisition Cards, Treasury Board, 2009
The procurement contracts of the selected small entities are awarded and administered in a fair, open, and transparent manner, consistent with relevant authorities.	• *Financial Administration Act* • Contracting Policy, Treasury Board, 2008 • *Government Contracts Regulations* • Supply Manual, Public Works and Government Services Canada
The selected small entities have effective controls for the management of spending on executive travel and hospitality that are consistent with relevant authorities.	• *Financial Administration Act* • Travel Directive, Treasury Board, 2008 • Special Travel Authorities, Treasury Board, 2009 • Hospitality Policy, Treasury Board, 2009

To determine whether the small entities had sound human resource management practices for selected areas of human resources, we used the following criteria:	
Criteria	**Sources**
The selected small entities have an adequate human resource planning process that identifies their human resource needs in a way that is consistent with their operational requirements.	• Management Accountability Framework, Treasury Board of Canada Secretariat • Integrated planning handbook for deputy ministers and senior managers, Treasury Board of Canada Secretariat, 2008
The selected small entities have a structured performance management system in place to manage employee's performance that is consistent with the relevant authorities.	• *Financial Administration Act* • Gold Standard, Treasury Board of Canada Secretariat • Sixteenth Annual Report to the Prime Minister on the Public Service of Canada, Privy Council Office, 2009 • Clerk's 2009–10 Public Service Renewal Action Plan, Privy Council Office
The selected small entities comply with the requirements of the applicable authorities related to the performance management and performance pay of executives and Governor in Council appointees.	• Directive on the Performance Management Program for Executives, Treasury Board, 2007 • Performance Management Program for Deputy Ministers, Associate Deputy Ministers, and Individuals Paid in the GX Range, Privy Council Office • Performance Management Program for Heads of Agencies and other Governor in Council Appointees Eligible for Performance Pay, Privy Council Office • Treasury Board of Canada Secretariat response to the 11th and 12th Stephenson Committee Reports (Reports of the Advisory Committee on Senior Level Retention and Compensation)

Criteria	Sources
The selected small entities comply with the Policy on the Management of Executives and elements of the related Directive on Executive Compensation.	• Policy on the Management of Executives, Treasury Board, 2007 • Directive on Executive Compensation, Treasury Board, 2008 • Terms and Conditions of Employment for Full-Time Governor in Council Appointees, Privy Council Office, 2009

Management reviewed and accepted the suitability of the criteria used in the audit.

Period covered by the audit

For the areas of acquisition cards, contracting, executive travel, and hospitality, the files reviewed focused on the 2008–09 fiscal year. For the area of human resource management, the files reviewed focused on a three-year period from 2006 to 2009. Audit work for this chapter was substantially completed on 16 March 2010.

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Appendix List of recommendations

The following recommendation is found in Chapter 2. The number in front of the recommendation indicates the paragraph where it appears in the chapter. The numbers in parentheses indicate the paragraphs where the topic is discussed.

Recommendation	Response
Human resource management	
2.30 The Canadian Forces Housing Agency, the Canadian Pari-Mutuel Agency, and the Pension Appeals Board should ensure that performance agreement and appraisal forms for executives are consistently completed and documented in accordance with the requirements of the Treasury Board Directive and guidelines on the Performance Management Program for Executives. **(2.21–2.29)**	**The Canadian Forces Housing Agency's response.** Agreed. For the current year's Performance Management Program for Executives process, the directorate responsible for civilian executive services within National Defence will ensure that comprehensive file records are maintained of all completed performance assessments for National Defence executive employees, including the Canadian Forces Housing Agency executives. The Agency will continue to ensure that performance agreements and assessments are prepared in accordance with the Treasury Board of Canada Secretariat's direction and National Defence guidelines. **The Canadian Pari-Mutuel Agency's response**. Agreed. The Canadian Pari-Mutuel Agency is part of Agriculture and Agri-Food Canada's performance management process for the executive group. The Department will review its current process for obtaining both the employee and the manager's signatures and make the appropriate adjustments by 30 September 2010. **The Pension Appeals Board's response.** Agreed. Effective immediately, the Pension Appeals Board and Human Resources and Skills Development Canada will ensure that performance agreements for executives at the Pension Appeals Board are duly signed.

Report of the Auditor General of Canada to the House of Commons—Fall 2010

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2010



Report of the

Auditor General of Canada

to the House of Commons

FALL

Chapter 3
Service Delivery

Office of the Auditor General of Canada



2010



Report of the Auditor General of Canada to the House of Commons

FALL

Chapter 3
Service Delivery

Office of the Auditor General of Canada

The Fall 2010 Report of the Auditor General of Canada comprises Matters of Special Importance, Main Points—Chapters 1 to 9, Appendices, and nine chapters. The main table of contents for the Report is found at the end of this publication.

The Report is available on our website at www.oag-bvg.gc.ca.

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Chapter

3

Service Delivery

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Service Delivery

Main Points

What we examined

The federal government delivers a broad range of services that affect the well-being of individuals and organizations across the country and abroad. Deputy heads of federal organizations are responsible for managing the delivery of these services in accordance with their organizations' objectives, guidelines, and procedures.

We looked at the practices used by three organizations—Citizenship and Immigration Canada, Human Resources and Skills Development Canada, and the Canada Revenue Agency—to set their service standards, monitor and report on their service performance, and act on this information to improve service quality.

Audit work for this chapter was substantially completed on 31 March 2010.

Why it's important

The federal government delivers many services directly to millions of individuals, ranging from issuing passports to answering tax inquiries, to processing claims for Employment Insurance. All Canadians require the services of the federal government at one time or another, and research indicates that they expect high-quality service. At the same time, the government must balance clients' service needs with policy requirements and available resources.

What we found

- Citizenship and Immigration Canada has been working to develop service standards since 2007. It has so far established a limited number of standards, and these do not cover some of its major programs. Therefore, the Department cannot fully measure and report on its service performance. Nevertheless, it has some processes already in place that could form the basis for more comprehensive monitoring of service quality. The Department has taken action to better manage the quality of its service delivery, in line with its strategic priority of improving its service to clients.
- Human Resources and Skills Development Canada has client-oriented standards covering its main services. It uses these service standards to monitor and report on its performance. Through ongoing monitoring of performance against these service standards

and through collecting feedback from its clients, the Department has identified issues and taken action in several areas to improve service.

- The Canada Revenue Agency has set service standards for services it has determined are important to its clients and has well-established processes for assessing its clients' needs and expectations. Many transactions that were once largely paper-based are now offered by telephone and on the Internet. While service standards have been added and updated, some may not reflect clients' current priorities. The Agency is in the process of reviewing and updating its service standards, which will provide it with an opportunity to ensure that its standards reflect current client and operational needs.

The organizations have responded. The organizations agree with our observations. Citizenship and Immigration Canada's response follows the recommendation in the chapter.

Introduction

The importance of service delivery

3.1 The Canadian federal government delivers a broad range of services that have a direct impact on the well-being of individuals and organizations across the country and abroad. The services for individuals are varied, including those that might be received regularly and for an extended period, such as social benefit payments; those that might be accessed only once, such as applications for Canadian permanent residency and citizenship; or those that might be required periodically, such as renewal of a passport.

3.2 Research in Canada has shown that the public wants and cares about high-quality service from their government. At the same time, government organizations must balance cost and quality, while weighing the interests of individual **clients** against broader public interests, policy requirements, and resource limitations. In some cases, how a federal organization delivers a program is defined in its legislation.

Clients—In this context, clients are individuals who use federal government programs.

3.3 Service also matters to parliamentarians and public servants, and efforts to improve public sector service delivery have been going on since the 1970s. The Treasury Board of Canada, through its Secretariat, has led and coordinated several initiatives aimed at making the government's service delivery more client-focused; recent examples are the 1995 Quality Services Initiative and a five-year Service Improvement Initiative that began in 2000.

3.4 The main principles contained in the Policy Framework for Service Improvement—a key part of the 2000 initiative—are a results-based approach to achieving high-quality service. With this approach, organizations engage in public consultation to determine their clients' service priorities, develop **service standards** and **targets** and use these to measure and report on performance, and improve service as part of a continuous cycle. The Treasury Board's Management Accountability Framework sets out similar expectations for well-managed government service delivery.

Service standard—The measurable level of service that clients can expect to receive under normal circumstances (for example, respond to telephone inquiries in queue within two minutes)

Service target—The degree to which an organization expects to meet a service standard (for example, respond to telephone inquiries in queue within two minutes for 90 percent of calls)

3.5 Within federal organizations, deputy heads are responsible for managing service design and delivery in accordance with their organizations' mandates and organizational and program legislation. In order to achieve and maintain high-quality service, it is important for organizations to establish service standards, monitor service

performance, and take action to improve service when issues are identified.

- **Establishing service standards.** To objectively assess whether an organization is meeting its commitments to high-quality service (for example, courteous, prompt, and fair treatment), it should set service standards that reflect its clients' needs and service targets to measure the degree to which it expects to meet the standards. An organization should also communicate its service standards to clients, so they know what level of service they can expect, and to employees who deliver the service, so they know what the organization expects of them.
- **Monitoring service performance.** To identify service quality issues, an organization needs to monitor its performance by comparing actual with expected performance against the service targets it has set. An organization also needs to gather information on how satisfied clients are with the service—through means such as feedback from surveys and from compliments and complaints received. Two other useful sources of information on service performance are input from employees who deal directly with clients and results of quality controls—for example, telephone calls monitored for quality and training purposes. As well, an organization needs to report its service performance to Parliament and the public; publishing its results is important for accountability and transparency.
- **Acting to improve service performance.** By analyzing the results of monitoring service performance, an organization should check whether its service is achieving targets and, if not, determine the reason(s). The organization then needs to identify the steps required to improve its service, set priorities for action, and implement the necessary changes.

3.6 The current audit looked at how Citizenship and Immigration Canada, Human Resources and Skills Development Canada, and the Canada Revenue Agency manage the quality of service they deliver to their clients. We selected these organizations because of the volume and importance of services they provide directly to individuals. These three organizations represent different scales of operation as well as different organizational models for delivering service within the federal government.

3.7 Citizenship and Immigration Canada. Citizenship and Immigration Canada, employing about 4,000 people, is a government department that provides a variety of services to individuals both

within Canada and abroad. It selects permanent and temporary residents, assists with immigrant settlement and integration, and offers Canada's protection to refugees. The Department also processes applications for Canadian citizenship, and it provides citizens with certificates to prove their citizenship status. In the 2008–09 fiscal year, it authorized about 247,000 people to live in Canada as permanent residents, processed applications for over 1.5 million visitors to Canada (tourists, students, and workers), and granted citizenship to about 186,000 individuals. The Department also implements special measures in response to emergencies, such as Typhoon Ketsana in the Philippines (September 2009) and the earthquake in Haiti (January 2010).

3.8 **Human Resources and Skills Development Canada.** Human Resources and Skills Development Canada, employing about 24,000 people, delivers some of the largest government programs providing service to individuals. In the 2008–09 fiscal year, over 8 million individuals received either the Canada Pension Plan retirement benefit or the Old Age Security pension, and over 3 million individuals applied for Employment Insurance benefits. The Department spends about $83 billion on programs and services that benefit people directly. In 2005, Service Canada was established within the Department to provide integrated and easy-to-access service for the Department's own programs as well as for other federal government organizations. In the 2008–09 fiscal year, Service Canada received almost 10 million visitors to its in-person points of service and more than 55 million telephone calls.

3.9 **The Canada Revenue Agency.** The *Canada Revenue Agency Act*, 1999, gives it more autonomy than government departments for administrative matters. The Agency employs about 41,000 people. One of the objectives in creating the Agency was to provide better service to clients. In the 2008–09 fiscal year, the Agency processed more than 27 million individual and trust tax returns and distributed about $9.5 billion in child tax benefits to almost 3.5 million families. The Canada Child Tax Benefit program is one of six federal and 20 ongoing provincial and territorial benefit programs that the Agency administers, which together reach over 20 million people. In the 2008–09 fiscal year, there were over 79 million visits to the Agency website, and the Agency handled more than 25 million public inquiries.

3.10 **Previous audit findings.** Between 1996 and 2000, the Auditor General conducted three audits of service delivery. Our 1996 September Report, Chapter 14—Service Quality, found that implementation of service standards was incomplete and measures of

performance were not consistently available. The 1996 Report also found that client priorities had been taken into account for only about half the services we examined and that information on client satisfaction had been gathered for even fewer services. Our 2000 April Report, Chapter 1—Service Quality, found significant improvements since 1996, but there were still gaps in performance information and insufficient client consultation. In that same report, Chapter 2—Human Resources Development Canada: Service Quality at the Local Level, we found that the Department had made progress in addressing service quality but that communication of service targets to clients was inconsistent and performance measures were incomplete.

Focus of the audit

3.11 The objective of the audit was to determine whether Citizenship and Immigration Canada, Human Resources and Skills Development Canada, and the Canada Revenue Agency have adequate practices to manage the quality of service they deliver to individuals.

3.12 We examined the corporate management practices followed by the three organizations for delivering service to individuals—that is, how the organizations set their service standards, monitor and report on their service performance, and act on the performance information to improve service quality.

3.13 In addition, to determine how corporate management practices are applied to specific programs, we selected the following key services for examination:

- processing of applications for citizenship and requests for citizenship certificates—the two main services within Citizenship and Immigration Canada's Citizenship Program;
- delivery of Employment Insurance income benefits by Human Resources and Skills Development Canada; and
- delivery of child and family benefits by the Canada Revenue Agency.

3.14 The audit covered the practices to manage the quality of service that the three organizations deliver to individuals (not to incorporated businesses and non-profit groups). We looked at how each organization identifies systemic service issues; we did not examine specific service transactions with individuals. Each of the three organizations we examined has a different mandate, legislation, and client base, and we did not compare or contrast their management practices.

3.15 More details on the audit objective, scope, approach, and criteria are in **About the Audit** at the end of this chapter.

Observations and Recommendation

3.16 Our observations related to Citizenship and Immigration Canada, Human Resources and Skills Development Canada, and the Canada Revenue Agency are presented separately.

Citizenship and Immigration Canada

3.17 Citizenship and Immigration Canada's services, such as granting permanent residency and citizenship, involve complex processes and a variety of screening activities to protect Canada's safety and security. The Department provides its services in Canada through about 40 local offices, 3 processing centres, and a call centre for domestic inquiries; it also has a network of over 80 points of service abroad. Applications for services are largely paper-based; however, the Department is in the process of implementing online applications and, as of December 2009, temporary resident applications within Canada can be made online. Clients can also gain access to services and find out about the status of their application by Internet, phone, mail, and email, and in person. Rather than contacting the Department themselves, clients may ask their members of Parliament to obtain application status information on their behalf. The communication channels available to members of Parliament are similar to those available to the public.

The Department has few service standards

3.18 We found that Citizenship and Immigration Canada has few service standards, and these were recently developed.

3.19 The Department has been working to develop service standards since 2007. In April 2010, it published, for the first time, a service declaration—a public commitment to, among other things, provide clients with quality services, treat clients with courtesy and respect, and publish application processing times. Simultaneously, the Department published a preliminary set of service standards and associated targets for four business lines as a step toward testing its ability to measure and report on results. We found that the Department had incorporated input from clients to clarify the wording of the new service declaration and service standards.

3.20 Considering that the Department provides more than 35 different services, this set of standards is very limited (Exhibit 3.1).

There are no standards for some major services provided by the Department—for example, the Citizenship Program. Without a complete set of service standards, the Department cannot comprehensively evaluate its service performance and may not be able to ensure a consistent level of service to its clients.

3.21 Because the Department has no service standards for its Citizenship Program, we examined how the Department communicates to clients the length of time it takes to process applications for citizenship and requests for new or replacement citizenship certificates. The Department uses information on past processing times to inform clients about how long they will have to wait for results.

Exhibit 3.1 Citizenship and Immigration Canada has service targets for only 4 of its more than 35 services

Service	Service standard and target April 2010
Opinion to Employers on Exemption from Labour Market Opinion (opinion provided to employers on whether an assessment by Human Resources and Skills Development Canada on the labour market impact of bringing in a foreign worker is needed, prior to a worker applying for a temporary work permit)	In 80 percent of responses to employers, to provide an opinion within 5 business days from the time a complete request is received.
Permanent Resident Family Class Application Overseas (spouses, common-law partners, conjugal partners, and dependent children applying for permanent residency from overseas)	In 80 percent of overseas applications, to make a final decision on the application within 12 months from the time the application is received at the Mississauga Case Processing Centre.
Initial Permanent Resident Card	For 80 percent of new permanent residents, to send their initial permanent resident card within 40 business days from the time the confirmation of permanent resident form is completed at a port of entry or at a Citizenship and Immigration Canada inland office.
Grants and Contributions (for example, funding to help immigrants settle in Canada)	To acknowledge receipt of all proposals submitted within 7 business days of the closing date of the call for proposals. To advise applicants in writing of the Department's decision pertaining to the eligibility of the applicant for further processing within 30 business days of receiving a signed and completed application form. To provide all eligible applicants with a funding decision on their application within 90 business days of confirming their eligibility for funding or to inform the applicants within that time frame of any additional processing time that may be required.

Source: Citizenship and Immigration Canada

3.22 We found that the information on processing times for the Citizenship Program varies according to the channel of communication. Clients can obtain this information in three ways: in the letter acknowledging receipt of application, on the Department's website, and by telephoning the call centre. However, these channels do not provide consistent information, which can be confusing for clients. Processing times on the website are updated from time to time; however, due to information system restrictions, the letters acknowledging applications for Canadian citizenship and requests for citizenship certificates have not been revised since 2005 and thus do not always reflect current processing times. For example, at the time of our audit, the acknowledgement letters stated that it takes five to seven months to process a citizenship certificate request, while the website stated that the processing time was 10 months. The Department identified the need to update the acknowledgement letters and planned to make these changes as part of an update to the information system scheduled for May 2010.

The Department does not have a comprehensive way to monitor service performance

3.23 We found that, in the absence of service standards for its major programs, Citizenship and Immigration Canada does not have a comprehensive way to monitor service performance. At the time of the audit, it was using operational data, such as intake, output, processing times, and inventories to provide some indication of performance. We found that the Department solicits feedback from its front-line employees and also monitors service quality at its call centre to help identify service issues. However, the Department does not track client feedback and complaints systematically.

3.24 The Department has some processes in place that could form the basis of a more comprehensive system for monitoring service quality. These include

- a central unit responsible for managing the collection, analysis, reporting, forecasting, and dissemination of operational data such as intake, output, processing times, and inventories;
- a management committee that regularly monitors the monthly operational dashboard—a consolidation of operational performance information and risks for all programs; and
- regular monthly reporting on operational data to the central unit by regional offices.

3.25 We found that the Department collects input from front-line employees on its performance to identify service quality issues and opportunities for improving service. For example, employees from regions in Canada regularly participate in a variety of national working groups on improving service. The Department also monitors the quality of service provided by its call centre agents. This information is used not only to identify areas for improvement for individual agents but also to identify systemic service issues that require broader attention—for example, training to improve call centre agents' responses to inquiries on legislative changes.

3.26 In our examination of the Citizenship Program, we found that the Department does not have a systematic way to collect and interpret information from clients on the quality of its service delivery. Clients can provide input about information content on the website and in printed material. However, we found that the Department collects little information on clients' satisfaction with the delivery of the Citizenship Program. Clients and members of Parliament acting on behalf of their constituents may also contact the Department to register complaints about service, but the Department does not collect this information in a way that allows for analysis. Without analyzing client feedback and complaints, the Department may receive recurring requests and inquiries that increase its workload while missing opportunities to resolve systemic service issues in a timely manner.

3.27 The Department's published reports to Parliament and the public contain limited performance information on the quality of its service delivery. Nevertheless, we found that the Department has reported the steps it has taken to improve client service, including its progress in developing the service declaration and service standards.

Improving service is a priority of the Department

3.28 We found that Citizenship and Immigration Canada is acting to improve its service delivery. Improving client service has been a strategic priority of the Department since 2006.

3.29 In 2006, the Department created its Service Innovation Office to provide leadership and coordination for service delivery and a governance structure to facilitate decision making and priority setting. Since that time, Citizenship and Immigration Canada has made several improvements affecting the delivery of its Citizenship Program, including the following:

- modernizing its call centre,

- revamping its website, and
- improving Internet access for clients seeking information about the status of their file.

3.30 According to the Department, the Citizenship Program's main service delivery challenge is that, over the last several years, the volume of applications for citizenship and requests for citizenship certificates has significantly exceeded the Department's ability to process them in a timely manner; this has resulted in large backlogs and longer processing times. Delays in processing citizenship applications and requests for citizenship certificates mean that clients must wait longer to obtain important rights and services—for example, to vote or apply for a Canadian passport. Delays can also hamper the Department's efficiency as it must reassign resources to deal with urgent requests and respond to numerous inquiries about the status of applications.

3.31 The Department has tried to find more efficient procedures where possible. For example, it has explored options for streamlining the citizenship granting process and implementing an electronic application process. However, a new process would require computer system changes, which have been delayed due to other departmental priorities. Meanwhile, regional offices have taken steps to improve efficiency locally. For example, in some circumstances, applicants have been allowed to write their citizenship knowledge test and, if they pass, to take the citizenship oath immediately afterwards rather than attend a separate ceremony at a later date.

3.32 In addition, the Department has requested and received temporary funding to help reduce the growing backlogs in the Citizenship Program. In October 2009, it received $4.5 million to help reduce the backlog of requests for citizenship certificates. However, despite this funding and the measures taken, the Department is still faced with an ongoing challenge of how to manage very high demand in the Citizenship Program.

3.33 During our audit, Citizenship and Immigration Canada faced a sudden increase in demand for its services as a result of the January 2010 earthquake in Haiti. The following case study describes the Department's response to this emergency and shows how it mobilized resources to take action to meet the service needs of its clients.

Case study—Acting to improve service in a crisis situation

In January 2010, a devastating earthquake hit Haiti. As a result of this international crisis, Citizenship and Immigration Canada received a significant increase in requests and inquiries for its services from the public. The Department took several actions to respond to this increase in demand while maintaining its regular operations.

It implemented measures to accelerate and set priorities for processing various immigration and citizenship applications of people affected, including special measures for adoptions in process. It also established a temporary office in Canada to provide basic services, replacing the embassy services interrupted in Haiti.

Further, the Department took immediate steps to facilitate communications with clients. It set up a separate electronic mailbox to handle correspondence on adoptions in process as well as an additional one for general inquiries on the Haiti crisis. It also adjusted the call centre voice response system to provide up-to-date information and caller priority for those affected by the crisis, and it extended its hours of operation to deal with the increased demand. In addition, the Department set up temporary outreach services in several cities in Canada to handle inquiries and requests from Haitian communities.

To manage the increase in demand, the Department monitored the situation daily to identify service issues and determine actions needed.

The Department indicated that, since the adoption of these special measures, Canada had welcomed over 2,100 Haitians as of 1 April 2010, of which more than 200 were children.

Source: Citizenship and Immigration Canada

3.34 **Recommendation.** Citizenship and Immigration Canada should

- ensure that all channels of communication with clients provide consistent information on the time it takes to process applications for citizenship and requests for citizenship certificates,
- establish and communicate a comprehensive set of service standards for all key services it delivers,
- monitor and report on its service performance against these standards, and
- collect and analyze client feedback and complaints to identify systemic service issues.

The Department's response. Agreed. Citizenship and Immigration Canada places a high value on client service, and progress is being made in this area, including the following:

- Work is under way and will continue to ensure that applicants for citizenship and for citizenship certificates receive consistent messaging on processing times. Changes to citizenship acknowledgement letters were made in May 2010 as part of an IT system (Global Case Management System) upgrade that included modifications to the Citizenship module and roll out to the

International Region program. Processing times that quickly became outdated have been removed from the letters, and the letters now refer clients to the Department's website for processing times. Standardizing the remaining channels of communication should be finalized in September 2010.

- The Department is committed to implementing service standards as they will enhance the Department's accountability to the public and allow it to measure its performance. The long-term goal is to have service standards in place for all key lines of business. With the benefits of lessons learned on the implementation of Phase I (Exhibit 3.1) and input received from clients, the Department is assessing business lines for Phase II in order to implement these additional service standards by 1 April 2011.
- The Department plans to monitor its progress on meeting these standards quarterly. At the end of each fiscal year, the Department will report on that progress externally.
- The Department initiated a Client Feedback Mechanism project in 2009. A client satisfaction survey will be administered in 2010–11. An action plan to improve ongoing collection and analysis of clients' feedback will be developed in 2011 and implemented by spring 2012.

Human Resources and Skills Development Canada

3.35 Within Human Resources and Skills Development Canada, Service Canada's service delivery network includes a national telephone information service (1 800 O-Canada); specialized call centres for inquiries about the Canada Pension Plan, Old Age Security, and Employment Insurance; online services; more than 300 Service Canada Centres across Canada, where Canadians can be served in person; and over 200 scheduled outreach visits annually to provide government services to rural and remote communities.

Service standards reflect the needs of clients

3.36 In 2005, the Department published a service charter for Service Canada committing to providing clients with easy-to-access, personalized service. In 2006, it introduced service standards to define the level of service clients could expect—for example, standard hours of operation for call centres and offices and standard wait times for Employment Insurance payments. In 2009, the Department reported that it had 15 service targets associated with the standards for measuring the performance of the main services. For example, an individual who applies for benefits can expect notification of receipt of

the application within seven days; Service Canada expects to meet this target for 80 percent of applicants. Exhibit 3.2 lists a selection of service standards and targets and the results achieved.

3.37 We found that the Department had sought feedback from focus groups and it had researched how public and private sector service organizations had gained client support. This assisted in developing its service standards in 2006.

3.38 We also found that the Department clearly and consistently communicates its service standards to clients at its Service Canada Centres, on Service Canada's website, and through printed publications and public reports. The Department also clearly communicates its service standards and targets to its employees through mandatory training at the Service Canada College—the Department's corporate learning institution. Annually, over 1,000 client service employees take the Department's Service Excellence Certification Program. The Department also reinforces the importance of customer service through ongoing training and coaching, bulletins and communications, and incentives for employees to achieve high-quality service delivery.

Exhibit 3.2 Selected Service Canada service standards, targets, and results

Service	Service standard and target 2008–09		Result 2008–09
Service Canada provides Canadians with access to its services within 50 kilometres of where they live.	Percent of Canadians with access within 50 kilometres of where they live.	90%	95.6%
The 1 800 O-Canada call centre agents provide service from 8:00 a.m. to 8:00 p.m., Monday to Friday.	Percent of general calls answered by an agent within 18 seconds (1 800 O-Canada).	85%	87%
Service Canada accurately pays Employment Insurance claims.	Payment accuracy of Employment Insurance	95%	95.7%
Service Canada pays Employment Insurance claims within 28 days of filing.	Percent of Employment Insurance benefit payment or non-payment notifications issued within 28 days of filing.	80%	79.1%
Service Canada pays Old Age Security basic benefits and Canada Pension Plan benefits within the first month of entitlement.	Percent of Canada Pension Plan retirement benefit payment or non-payment notifications issued within the first month of entitlement.	85%	91.3%
	Percent of Old Age Security basic benefit payment or non-payment notifications issued within the first month of entitlement.	90%	92.1%

Note: The figures were not audited by the Office of the Auditor General.
Source: Human Resources and Skills Development Canada

The Department monitors service quality

3.39 We found that Human Resources and Skills Development Canada regularly monitors its performance against service standards and has several ways to collect feedback from clients about service satisfaction to identify service quality issues. Although employees provide feedback about service quality based on their interactions with clients, the Department does not have a systematic way to collect this information from employees.

3.40 **Ongoing monitoring.** The Department measures its service performance mainly by monthly tracking of actual results compared with planned service targets. It rates the results on whether they fall below targets, meet targets, or surpass targets in order to identify where service improvements are needed. The Department uses this information as a basis for reporting to Parliament and the public on Service Canada's service performance. We found that its corporate reports set out results clearly and consistently.

3.41 The Department's other monitoring activities include "mystery shopper" exercises, where evaluators pose as clients to gain insight into clients' service needs. The Department also checks the quality of service provided by agents during telephone inquiries and during interactions at Service Canada Centres about specific services. Managers use the resulting monitoring reports to identify where additional employee coaching and training is needed. As well, the Department tracks the in-person demand for the different services offered at Service Canada Centres. We found a good practice in one region: analyzing demand against labour market profiles (determined from the 2006 Census) to determine links between clients' occupational groups and the services they use. This helped determine where additional service delivery efforts were needed.

3.42 **Client feedback.** In 2005, the Department created its Office for Client Satisfaction to receive, review, and act on feedback from clients. The Office received over 3,000 complaints in the 2008–09 fiscal year. As well, the Department reported that, in the 2008–09 fiscal year, almost 23,000 clients completed comment cards giving feedback, including suggestions, compliments, or complaints, about the service they had received. Based on the Department's analysis of these and other sources, among the top complaints were wait times and insufficient staff at Service Canada Centres, problems getting through on the telephone, and the length of time it took to process an Employment Insurance claim.

3.43 In early 2009, the Department began consolidating the information from ongoing monitoring and client feedback as well as from ministerial correspondence. To complement this information, it uses the results from its periodic Service Canada client satisfaction surveys. The Department informed us that it plans to use the consolidated results to identify service quality issues but that it has not yet gathered sufficient information for analysis.

3.44 **Employee feedback.** Although employees provide feedback to managers about service quality issues they encounter in dealing with clients, we found that how information from employees is collected and used varies by region. The Department intends to systematically capture this information to help identify service gaps and opportunities for improvements in service delivery.

The Department has acted to improve service

3.45 We found that Human Resources and Skills Development Canada has acted on issues that it identified through monitoring service quality. Measures taken include the following:

- extending hours at some Service Canada Centres and call centres;
- automating Employment Insurance processing—the Department reported that in the 2008–09 fiscal year over 30 percent of initial claims were processed electronically;
- introducing the electronic National Workload System for processing Employment Insurance claims—enabling the workload to be distributed to employees across the country, as opposed to being distributed manually within regions, to achieve greater efficiency; and
- developing a plan to direct the routine inquiries about Employment Insurance, the Canada Pension Plan, and Old Age Security to the 1 800 O-Canada call centre, leaving the Department's more specialized agents time to deal with the more complex calls.

3.46 The following case study is an example of how the Department monitored its performance for Employment Insurance services, identified a potential service quality issue, and acted to improve its service.

Case study—Acting to improve service for Employment Insurance

Human Resources and Skills Development Canada reported that, in December 2008, it received more than 420,000 Employment Insurance claims, up almost 38 percent from November 2008 and about 32 percent from December 2007. In January 2009, the government announced Canada's Economic Action Plan, further increasing demands for service.

To avoid processing delays that could be caused by the significant spike in demand, the Department requested and received additional funding to deal with the high volume of Employment Insurance and work-sharing requests.

The Department also created a task force to manage the increased workload and set up five specialized processing centres across the country. These centres dealt with contentious claims—about a quarter of the total—that delay service delivery. At the same time, the Department reviewed Service Canada College training for new employees. It reported that it hired and trained about 3,900 new temporary employees.

Not only did the Department provide the service necessary to deal with the unprecedented increase in Employment Insurance claims, but it also achieved its service target for its speed of payment (80 percent of claims paid or notification of non-payment issued within 28 days of filing) more consistently than in the past.

Source: Human Resources and Skills Development Canada

The Canada Revenue Agency

3.47 The Canada Revenue Agency aims to make information and tools available to its clients in a manner that is best suited to their needs, abilities, and preferences; this encourages compliance with tax legislation and facilitates access to benefits to which they may be entitled. The Agency provides its service through four main channels: in person, and by mail, phone, and the Internet. A strategic goal is to have the majority of taxpayers and benefit recipients conduct their tax and benefit affairs with the Agency through self-service (by Internet or telephone) while still having access to a choice of channels.

The Agency is reviewing its service standards

3.48 The Agency commits to providing its clients with service that is accessible, prompt, accurate, fair, and professional. The Agency also published a Fairness Pledge that its service will be responsive, consistent, and impartial, while recognizing that clients have specific needs and concerns. In 2007, it introduced the Taxpayer Bill of Rights, explaining what clients can expect when dealing with the Agency. Eight of the 15 rights are service-related (Exhibit 3.3).

3.49 The Agency has established service standards and targets in areas that it has determined are important to taxpayers and benefit recipients. At the time of the audit, it had 47 service standards, up from about 30 in the 1999–2000 fiscal year. Exhibit 3.4 sets out

selected service standards and targets and performance results for the 2008–09 fiscal year (focusing on general inquiries and benefit programs as examples).

Exhibit 3.3 Taxpayers' service-related rights

Service-related rights included in the Taxpayer Bill of Rights are the right to

- be treated professionally, courteously, and fairly;
- receive complete, accurate, clear, and timely information from the Canada Revenue Agency (the Agency);
- lodge a service complaint and be provided with an explanation of the Agency's findings;
- have the costs of compliance taken into account when tax legislation is administered;
- expect the Agency to be accountable;
- expect the Agency to publish service standards and report annually;
- expect the Agency to warn about questionable tax schemes in a timely manner; and
- be represented by a person of one's choice.

Source: Taxpayer Bill of Rights, the Canada Revenue Agency

Exhibit 3.4 Selected Canada Revenue Agency service standards, targets, and results

Service	Service standard and target 2008–09		Result 2008–09
Taxpayer and business assistance			
General inquiries—telephone service	Respond to calls in queue within two minutes	80%	82%
Benefit programs			
Canada Child Tax Benefit—telephone service	Respond to calls in queue within two minutes	75%	78%
Processing benefit applications and marital status change forms—timeliness	Issue a payment, notice, or explanation within 80 calendar days	98%	97%
Processing benefit applications and marital status change forms—accuracy	Accurately process information and, if necessary, issue a payment, notice, or letter	98%	98%
Responding to benefit and credit inquiries—timeliness	Issue a payment, notice, or explanation within 80 calendar days	98%	98%
Responding to benefit and credit inquiries—accuracy	Respond to recipient written inquiries and telephone referrals from the call centres with the correct information, and process new recipient information including issuing a payment, notice, or letter accurately	98%	97%

Note: The figures were not audited by the Office of the Auditor General.
Source: The Canada Revenue Agency

3.50 We found that, as part of decision making on service standards and targets, the Agency conducts annual third-party surveys to measure clients' experiences and satisfaction with its services and programs. The results of the 2009 survey showed that 62 percent of individuals who had direct contact with the Agency to get information or receive a service gave a positive rating, while 19 percent were neutral; overall satisfaction with the Agency's performance had remained fairly stable since 2005.

3.51 However, we found that some of the Agency's standards have not been reviewed since the inception of the Agency over 10 years ago. Client satisfaction has been measured for about half of the 47 existing service standards, although the annual corporate survey measures client satisfaction with the Agency as whole. Meanwhile, the Agency has evolved from an organization whose transactions with clients were largely paper-based to one that encourages clients to self-serve using the website or telephone. While service standards have been added and updated, some may not reflect clients' current priorities. The Agency's guidelines for developing service standards (dating from 2006 and last updated in 2009) stress the importance of consultation in developing service standards to find out taxpayers' needs and expectations so that they can be balanced with the Agency's operational needs.

3.52 In mid-2009, the Agency began conducting a large-scale internal review of its service standards to determine whether it is communicating, monitoring, and reporting on the right services and the right targets in a meaningful way. This review was recommended by the Agency's Board of Management as being needed to identify and address where new standards could be implemented and where existing standards need improving, modifying, or removing in order to make service performance information more useful to clients. The Agency expects the report to be finalized in late 2010 and to contain a series of recommendations, including finding effective and efficient ways of taking client feedback into account when establishing service standards.

3.53 We found that the Agency communicates the Taxpayer Bill of Rights and service standards widely to its clients, both in its published reports and through its service channels; these channels include posters and pamphlets at Tax Services Offices, information on the Agency's website, and automated telephone messages.

3.54 The Agency communicates its service standards to its front-line employees and provides them with training on offering high-quality

service. The Agency informed us that, in the 2008–09 fiscal year, about 2,000 new call centre agents received training on technical and "soft skills." The Agency also evaluates front-line employees' service delivery on their annual performance appraisals. Tax Centres, Tax Services Offices, and call centres also have initiatives to help employees meet or exceed the targets.

The Agency monitors and reports on its service performance

3.55 We found that the Canada Revenue Agency regularly monitors performance across its programs to identify service quality issues. To monitor its service performance, the Agency has an automated system to compile the data from all its programs about actual performance against service targets. Once reviewed for quality, the information is used for managing the programs and improving program delivery as well as for corporate reporting.

3.56 The Agency reports annually to Parliament and the public on the results of its performance against its service standards. Published performance information on service also includes five-year trends, explanations of why service targets were not met, and proposed actions for improvement. We noted that, with a list of 47 service standards, the Agency's reports of results are complex. Clear and concise reporting is important for transparency, as well as for managing client expectations. The Agency has observed that its service standards could be better communicated to allow its clients to more easily find and understand the standards for the services they use; for instance, the standards could be grouped by client segment—individual and business could be two such segments.

3.57 The Agency monitors complaints as an important source of client feedback. In support of the service rights outlined in the Taxpayer Bill of Rights, the Agency established a process to handle service-related complaints regardless of program or service. If an individual is not satisfied with the service received, the first step is to contact the appropriate office—the Agency employee or office the person has been dealing with—to try to resolve the issue. If dissatisfied with the solution offered from Agency staff, the person has the right to make a formal complaint, in writing, through the Agency's Service Complaints program (launched in 2007). In the 2008–09 fiscal year, the program received about 3,000 complaints, over 2,500 of which were considered to be valid service-related ones. This represents a small portion of the more than 27 million tax returns and 25 million public inquiries processed by the Agency that year.

Taxpayers' Ombudsman—The mandate of the Office of the Taxpayers' Ombudsman is to conduct impartial and independent reviews of service-related complaints about the Canada Revenue Agency and also to identify systemic service issues

3.58 If a person is dissatisfied with the outcome from the Service Complaints program, he or she has recourse to the **Taxpayers' Ombudsman** for a final impartial review (the first Ombudsman was appointed in 2008). In the 2008–09 fiscal year, the first year of operations, the Ombudsman reported receiving about 5,000 inquiries, complaints, and requests for assistance, many of which were not related to his mandate or were resolved by providing the taxpayer with information. Some matters were referred to the Agency or another government department. Over 500 files required further investigation by the Ombudsman's office. For about 280 of these, the Canada Revenue Agency's original action was upheld. In many other cases, the Ombudsman's investigations led to corrective responses by the Agency on individual files or changes to Agency policies and procedures when the issues were systemic. The Ombudsman's office is working to improve its system for tracking data on corrective actions resulting from its reviews.

3.59 Both the Service Complaints program office and the Office of the Taxpayers' Ombudsman track complaints received to identify systemic service issues, and the Agency may adjust its processes as a result. The Agency also encourages front-line employees to provide input on improving service delivery, based on their interactions with clients. Depending on the nature of the issues and comments, managers use employees' comments locally, regionally, or at headquarters to make service adjustments. For example, following an employee's observation, the Agency clarified the wording on a commonly used form. The Agency is currently developing a tool to allow all employees to report, for further evaluation, any issue they believe to be systemic, thus making better use of an important source of information to assist early resolution of service quality problems.

The Agency has taken several steps to improve service quality

3.60 Part of the Agency's service strategy is to encourage taxpayers to use the more cost-effective, accessible service channels for transactions, such as the Internet and the telephone. A 2001 survey of clients visiting the in-person service offices showed that the majority favoured Internet and telephone options, but there was still a demand for walk-in service. In the 2007–08 fiscal year, the Agency transformed its in-person service to service by appointment at Tax Services Offices. An agent is assigned to the file and has time to study the file and gather information for responding to the query. Since making the change, the Agency has found that the majority of clients who call for appointments can be served by telephone without the need for an office visit. However, clients may still make an appointment if they wish.

3.61 The Agency uses various other sources of information to understand clients' needs and to find ways to improve service. As well as conducting annual corporate surveys, the Agency also conducts some program-specific surveys; for example, it annually measures applicants' satisfaction with the Canada Child Tax Benefit program services. The 2008 and 2009 surveys of first-time benefit applicants and regular users found that over 90 percent of clients were satisfied with the service they received.

3.62 The Agency has implemented a program to monitor the quality and accuracy of its call centre service, and it uses the results to give feedback to individual agents, identify training needs, and examine where it needs to change key elements of a telephone call. For example, the Agency informed us that of more than 23,000 calls monitored in the 2008–09 fiscal year, about 3 percent resulted in about 300 agents being given additional coaching and training to help them deal with more complex inquiries. The Agency has also conducted studies to investigate how clients use the different service channels. For example, by determining the nature of telephone calls, the Agency identified frequent topics and also improved written products, the information on and layout of its website, and topic-specific telephone messages. It has also conducted similar studies to identify the nature of inquiries about specific programs, such as the Canada Child Tax Benefit.

3.63 The following case study is an example from the benefits programs of how the Agency acted on an identified issue to improve service quality. It illustrates that service complaints are an important source of information about systemic issues.

Case study—Acting to simplify requirements for confirming marital status for the Canada Child Tax Benefit program

In February 2009, the Taxpayers' Ombudsman began a review based on complaints that the Canada Revenue Agency was inconsistent in applying the requirements for confirming marital status and living arrangements—part of the application process for the Canada Child Tax Benefit. Complainants also alleged that the Agency failed to take into account documentation they had supplied. The Agency's Service Complaints office had also received similar complaints, which it had dealt with case by case.

In May 2009, the Agency announced that it was easing the requirements and streamlining the process. The Agency recognized that, in the context of a breakdown of a marriage or relationship, it was often difficult to obtain the other spouse's or common-law partner's information in support of the benefit recipient's claim. For that reason, the Agency simplified the review process, and benefit recipients can now assess their situation and provide all required documents in one step.

At the time of the audit, the Office of the Taxpayers' Ombudsman was monitoring the effectiveness of the changes.

Source: The Canada Revenue Agency

Conclusion

3.64 We found that the three organizations we examined are at different stages in developing the necessary practices for delivering high-quality service to their clients. We concluded that Human Resources and Skills Development Canada and the Canada Revenue Agency both have adequate practices already in place. Citizenship and Immigration Canada is at an earlier stage of managing the quality of its service delivery, and we concluded that it does not yet have adequate practices in place. We found that all three organizations have acted to improve service delivery.

3.65 Citizenship and Immigration Canada has service standards for only four of more than 35 services. Without service standards, it cannot measure or report on the quality of service it provides. The Department has taken initial steps toward managing the quality of its service delivery by publishing service commitments to its clients and setting preliminary service targets. Although the Department does not yet have a comprehensive way to monitor service performance, it has some processes in place on which it can base a system for monitoring service quality. The Department has taken several steps to improve service to its clients.

3.66 Human Resources and Skills Development Canada has developed service standards that it communicates clearly to its clients and employees. The Department regularly monitors and reports its performance against these standards. As a result of regular monitoring, it has identified a number of service-related issues and has acted to resolve them.

3.67 The Canada Revenue Agency has established standards for services it has determined are important to its clients and it has well-established processes for assessing its clients' needs. It regularly monitors and reports its performance against its service standards. Since the Agency's inception over 10 years ago, it has evolved from an organization whose transactions with clients were largely paper-based to one that encourages clients to self-serve using the website or telephone. Although service standards have been added and updated, some may not reflect current client operational needs. The Agency is currently reviewing and updating its service standards to determine whether it is communicating, monitoring, and reporting on the right services, with the right targets in a meaningful way.

About the Audit

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by The Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

Objective

The audit objective was to determine whether Citizenship and Immigration Canada, Human Resources and Skills Development Canada, and the Canada Revenue Agency have adequate practices to manage the quality of service delivered to individuals.

In this case, having adequate practices means that the three organizations

- have service standards that take into account client needs,
- monitor their service performance to identify service quality issues and report on performance, and
- act on identified issues to improve service quality.

Scope and approach

We selected these three federal organizations for audit based on the volume of direct services they provide to individuals as well as other considerations (including previous and upcoming work by the Office of the Auditor General and the nature of the services provided). The audit covered service delivery to individuals and did not include service provided to incorporated businesses and non-profit groups.

The audit included examining whether the organizations collect and use information generated from complaints as a source for monitoring performance, identifying service quality issues, and making improvements. Therefore, the Office of the Taxpayers' Ombudsman was included in the scope of the audit as part of the Canada Revenue Agency's service complaints system. The Ombudsman's mandate is to conduct impartial and independent reviews of service-related complaints about the Agency and also to identify systemic service issues.

The audit team conducted its examination work through interviews at headquarters, site-visits, and document reviews of relevant information on file. It visited selected sites, including call centres, processing centres, in-person service centres, and regional offices to interview managers and front-line employees and to "walk through" procedures. The team reviewed documentary evidence to support information obtained from interviews, including corporate strategies and plans, meeting minutes and decision information, external and internal performance reports, publications for clients, quality assurance reports, and communications to employees.

Criteria

To determine whether the federal organizations have adequate practices to manage the quality of service delivered to individuals, we used the following criteria:

Criteria	Sources
Establishing service standards	
The federal organizations have service standards that reflect client needs (client opinions, expectations, priorities, and preferences).	• ISO 9000/1 Quality Management, International Organization for Standardization • Guidelines for Implementing ISO 9000 in Public Sector Organizations, Canadian General Targets Board, 2002 • Communications Policy of the Government of Canada—Policy Statement, Treasury Board, 2006
The federal organizations adequately communicate their service standards to their clients and employees.	• Public Sector Accounting Board Statement of Recommended Practice (SORP-2) • Communications Policy of the Government of Canada—Policy Requirement 1(i), Treasury Board, 2006
Monitoring and reporting on service performance	
The federal organizations regularly measure their service performance to identify service quality issues.	• ISO 9000/1 Quality Management, International Organization for Standardization • Guidelines for Implementing ISO 9000 in Public Sector Organizations, Canadian General Targets Board, 2002
The federal organizations report to Parliament and the public on their service performance.	• Public Sector Accounting Board Statement of Recommended Practice (SORP-2) • Guidance on the Assessment of Performance Information, Office of the Auditor General
Acting to improve service performance	
The federal organizations act on identified service quality issues to improve service.	• ISO 9000/1 Quality Management, International Organization for Standardization • Guidelines for Implementing ISO 9000 in Public Sector Organizations, Canadian General Targets Board, 2002

Sources common to all criteria
Organization-specific sources, including
• reports on plans and priorities
• departmental performance reports
• annual reports
• business plans and strategies
• management frameworks
• service standard documents
• management decision documents
Treasury Board of Canada sources:
• Policy Framework for Service Improvement in the Government of Canada, 2000
• Results for Canadians: A Management Framework for the Government of Canada, 2000
• Management Accountability Framework—Areas of Management for Results and Performance and Citizen-focused Service

Management reviewed and accepted the suitability of the criteria used in the audit.

Independence considerations

A family member of one of the Assistant Auditors General (AAG) responsible for this audit is a senior official of the Canada Revenue Agency. Professional standards characterize this as a close relationship with the audited entity, which could call into question the independence of the AAG. Therefore, to avoid any suggestion of bias, conflict of interest, or appearance thereof, for matters relating to the Agency, the AAG responsible for audits at the Agency assumed the role of AAG in providing assurance of audit quality and compliance with Office policies and professional standards.

Period covered by the audit

The audit covered the period between April 2007 and March 2010. However, some documents reviewed go back to 2001. Audit work for this chapter was substantially completed on 31 March 2010.

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Appendix List of recommendations

The following recommendation is found in Chapter 3. The number in front of the recommendation indicates the paragraph where it appears in the chapter. The numbers in parentheses indicate the paragraphs where the topic is discussed.

Recommendation	Response
Citizenship and Immigration Canada	
3.34 Citizenship and Immigration Canada should • ensure that all channels of communication with clients provide consistent information on the time it takes to process applications for citizenship and requests for citizenship certificates, • establish and communicate a comprehensive set of service standards for all key services it delivers, • monitor and report on its service performance against these standards, and • collect and analyze client feedback and complaints to identify systemic service issues. **(3.17–3.33)**	Agreed. Citizenship and Immigration Canada places a high value on client service, and progress is being made in this area, including the following: • Work is under way and will continue to ensure that applicants for citizenship and for citizenship certificates receive consistent messaging on processing times. Changes to citizenship acknowledgement letters were made in May 2010 as part of an IT system (Global Case Management System) upgrade that included modifications to the Citizenship module and roll out to the International Region program. Processing times that quickly became outdated have been removed from the letters, and the letters now refer clients to the Department's website for processing times. Standardizing the remaining channels of communication should be finalized in September 2010. • The Department is committed to implementing service standards as they will enhance the Department's accountability to the public and allow it to measure its performance. The long-term goal is to have service standards in place for all key lines of business. With the benefits of lessons learned on the implementation of Phase I (Exhibit 3.1) and input received from clients, the Department is assessing business lines for Phase II in order to implement these additional service standards by 1 April 2011. • The Department plans to monitor its progress on meeting these standards quarterly. At the end of each fiscal year, the Department will report on that progress externally. • The Department initiated a Client Feedback Mechanism project in 2009. A client satisfaction survey will be administered in 2010–11. An action plan to improve ongoing collection and analysis of clients' feedback will be developed in 2011 and implemented by spring 2012.

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to the House of Commons

Chapter 4

Managing Conflict of Interest

Office of the Auditor General of Canada



2010



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to the House of Commons

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Chapter 4

Managing Conflict of Interest

Office of the Auditor General of Canada

The Fall 2010 Report of the Auditor General of Canada comprises Matters of Special Importance, Main Points—Chapters 1 to 9, Appendices, and nine chapters. The main table of contents for the Report is found at the end of this publication.

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Chapter

4

Managing Conflict of Interest

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Managing Conflict of Interest

Main Points

What we examined

In the federal government, "conflict of interest" refers to a conflict arising between the public service duties of public servants and their private interests. Outside parties—consultants or contractors—may also have conflicts of interest in carrying out work for the federal government. At the time of our audit, the Values and Ethics Code for the Public Service, published in June 2003, was the government's main policy for conflict of interest as it applies to public servants.

We looked at what the Treasury Board of Canada Secretariat and five selected departments have done to ensure that public servants can recognize a conflict of interest, however it arises, and know how to deal with it. We had found cases of conflict of interest in previous audits in three of the departments: Agriculture and Agri-Food Canada, Natural Resources Canada, and Public Works and Government Services Canada. We included those departments as well as Canadian Heritage and Human Resources and Skills Development Canada in this audit.

Audit work for this chapter was substantially completed on 31 May 2010.

Why it's important

Conflict of interest is a government-wide issue that can extend across the public service to any department or agency. The public's trust in government institutions is fundamental to the work of Canada's public service. Whether apparent, potential, or real, conflicts of interest bring into question the integrity and fairness of decisions made by public servants. If not properly addressed, conflicts of interest can increase the level of distrust and cynicism toward government and, over time, impact the legitimacy and effectiveness of government actions.

What we found

- The Treasury Board of Canada Secretariat plays an important role, but is not providing sustained support to departments. Two areas that have suffered are policy guidance and training with content from the policy centre. This training supports departments and agencies in meeting common needs for training related to conflict of interest. The requirement to put in place new policies was also not met. As the responsible central agency, the Secretariat's role is

crucial in fostering a shared understanding of the rules that govern conflict of interest throughout the public service.

- The five departments we examined have put in place mechanisms and assistance to address conflict of interest and, overall, have met their obligations under the Values and Ethics Code. Departments have set up organizational units to deal with values and ethics, designated senior officials to help public servants resolve issues related to the application of the code, and provided guidance and training on conflict of interest. For example, departments use their intranet sites to inform public servants about conflict of interest and provide contact information for staff who can answer questions.
- The departments have put in place processes to analyze conflict of interest declarations and identify and assess potential issues, but they need to follow up on required action and make sure that declarations are dealt with in a timely manner. Where it was clear that there was no conflict of interest, files were processed quickly, but our file review found that in 11 cases out of 25, processing took more than 120 days. Without adequate and timely follow-up, management cannot be assured that measures have been taken to mitigate or eliminate conflicts of interest.
- The three departments where previous audits found cases of conflict of interest have taken steps to address the risks identified. However, at the time of our audit, none of the departments had reviewed all areas of its organization to identify risks of conflict of interest. When departments know where conflict of interest is likely to occur, they can help staff guard against this risk, for example, through training to help public servants understand the situations they could face and the best way to address them.

The Treasury Board of Canada Secretariat and the departments have responded. The Secretariat and the departments agree with our recommendations. Their detailed responses follow each recommendation throughout the report.

Introduction

4.1 In the federal government, the term "conflict of interest" refers to a conflict that arises between the work-related duties and private interests of public servants. The Values and Ethics Code for the Public Service requires any such conflict to be resolved in the public interest. This includes "perceived" or "apparent" conflicts of interest, where it could appear that public servants' private interests could improperly influence the way they perform their duties—whether or not this is the case. Outside parties—consultants or contractors—may also have conflicts of interest in carrying out work for the federal government.

4.2 The public's trust in government institutions is key to the work of the Public Service of Canada. Conflicts of interest can call into question the integrity and fairness of decisions that public servants make. While it may not be possible to avoid all situations of conflict of interest, these situations must be disclosed and addressed. If they are not properly managed, conflicts of interest can increase the level of distrust and cynicism toward government. Over time, government actions can come to be seen as less legitimate and less effective in such a climate.

Values and Ethics Code for the Public Service

4.3 In 1999, in response to a report issued by the Task Force on Public Service Values and Ethics (the "Tait Report"), the Treasury Board of Canada Secretariat created the Office of Public Service Values and Ethics. The role of this Office was to give departments guidance on ethics programs.

4.4 In June 2003, the government published the Values and Ethics Code for the Public Service. This code, which was in effect during the period covered by our audit, is the government's main policy for conflict of interest as it applies to public servants. The code establishes an important role for the Secretariat as the policy centre for government, including supporting departments and agencies in putting in place measures to avoid, identify, and manage conflict of interest. The code states that "Avoiding and preventing situations that could give rise to a conflict of interest, or the appearance of a conflict of interest, is one of the primary means by which a public servant maintains public confidence in the impartiality and objectivity of the Public Service." The code stresses that conflict of interest does not relate only to financial transactions and economic benefits. According to the code, public servants and deputy heads have specific responsibilities (Exhibit 4.1).

4.5 The code makes it clear that individual public servants, as a condition of employment, are responsible for examining their actions and reporting to their superiors any conflict of interest, whether it is apparent, real, or potential. This reporting is done through the "confidential report" or self-declaration. A public servant who does not comply with the code "is subject to appropriate disciplinary action, up to and including termination of employment." The code does not name specific penalties for different types of offences; but, given that termination is a possible consequence, public servants need to be able to identify when they may have a conflict of interest and know what steps to take to resolve the situation.

Exhibit 4.1 Responsibilities of public servants and deputy heads

According to the Values and Ethics Code for the Public Service, public servants must

- complete a "confidential report," or self-declaration report, within 60 days of their first appointment or any subsequent appointment, regarding all outside activities or assets that might give rise to a conflict of interest with respect to their official duties; and
- review their obligations under this code every time a major change occurs in their personal affairs or official duties and file a confidential report if a real, apparent, or potential conflict of interest exists.

Public servants should not

- have private interests, other than those permitted pursuant to these measures, that would be affected by government actions in which they participate;
- solicit or accept transfers of economic benefit;
- step out of their official roles to assist private entities or persons in their dealings with the government where this would result in preferential treatment to the entities or persons;
- knowingly take advantage of, or benefit from, information that is obtained in the course of their official duties and that is not generally available to the public; or
- directly or indirectly use, or allow the use of, government property of any kind, including property leased to the government, for anything other than officially approved activities.

Deputy heads (or their delegates) must

- ensure that letters of offer for new public servants refer to the code;
- ensure that public servants receive a copy of the code on any subsequent appointment and are reminded of the code's requirements once a year;
- encourage and maintain an ongoing dialogue on public service values and ethics within their organizations, in a manner that is relevant to the specific issues and challenges encountered by their organizations;
- ensure that mechanisms and assistance are in place to help public servants raise, discuss, and resolve issues of concern related to this code. This includes designating a senior official to assist public servants to resolve issues arising from the application of the code; and
- determine the appropriate method for a public servant to comply with the code in order to avoid conflicts of interest.

Source: Information adapted from the government's Values and Ethics Code for the Public Service.

4.6 The *Public Servants Disclosure Protection Act*, which took effect in 2007, includes in its definition of "wrongdoing" a serious breach of a code of conduct. It is possible that a significant conflict of interest would constitute such a breach and therefore be considered wrongdoing under the Act. The Act is intended to provide a secure and confidential process for such disclosure.

Conflict of interest programs in other jurisdictions

4.7 Other jurisdictions have different types of conflict of interest regimes in place. We conducted research on the systems for dealing with conflict of interest in two Canadian provinces, in other countries, and in the private sector. In our research, we found various approaches to managing conflict of interest. Some organizations require employees to make declarations regularly, even when there is no conflict to declare; others have set up governance and structures from the centre. Some jurisdictions and private sector companies have developed metrics to measure how effective their efforts are in managing conflicts of interest.

Findings in previous audits

4.8 Three recent audits have highlighted issues related to conflict of interest. Our May 2009 audit of Natural Resources Canada (NRCan) examined a conflict of interest relating to contribution agreements (conditional payments made to a private sector organization to deliver programs). A consultant involved in administering the program worked for the organization that received funding under the same program. Our December 2008 audit on contracting for professional services at Public Works and Government Services Canada (PWGSC) found cases of conflict of interest in the hiring of contractors. Contractors working at PWGSC helped develop the search criteria for contracts that were later awarded to them.

4.9 Our May 2007 audit of Agriculture and Agri-Food Canada (AAFC) discovered conflicts of interest where public servants who processed applications for farm income stabilization payments were helping producers complete those applications for a fee. In each of these audits, the departments had not taken steps to address these conflicts of interest until we brought them to the departments' attention.

4.10 The House of Commons Standing Committee on Public Accounts considered each of these audit chapters, which led to a report of the Committee to the House. All three departments said that changes had been or would be made to respond to the Office of the Auditor General's recommendations on managing conflict of interest.

Focus of the audit

4.11 The objective of this audit was to find out whether the Treasury Board of Canada Secretariat and five selected departments have provided the tools public servants need to meet the federal government's responsibilities for managing conflict of interest. We defined "tools" broadly as the authorities, methods, and processes—including guidance, training, and identification of areas of risk—that the Secretariat and departments offer to public servants. We also examined the level of knowledge that selected officials who are responsible for managing conflict of interest have about the subject. The audit covered three fiscal years: 2007–08, 2008–09, and 2009–10.

4.12 Audit work was carried out in the Secretariat and in three departments that we audited recently: AAFC, PWGSC, and NRCan. We added two other departments to our selection: Canadian Heritage, as an example of a small department focused on issuing grants and contributions, and Human Resources and Skills Development Canada, as an example of a department with a high dollar value of contracts and of grants and contributions.

4.13 More details about the audit objectives, scope, approach, and criteria are in **About the Audit** at the end of this chapter.

Observations and Recommendations

Role of the Treasury Board of Canada Secretariat

4.14 The Treasury Board has the authority to ensure coherent management in the government as a whole. In addition to the Values and Ethics Code for the Public Service, the main Treasury Board policy instruments for dealing with conflict of interest are the Contracting Policy and the Directive on Transfer Payments.

4.15 The Treasury Board Contracting Policy addresses conflict of interest in the administration of contracts for consulting and professional services, as follows:

> A consultant or professional, by virtue of the kind of service provided, may be in a position to exercise a bias toward a third party that could put the latter in a favoured position for future business with the Crown. If the consultant, professional or principals have a financial interest in the business of this third party, the policy requires the possibility of a conflict of interest to be considered. To avoid a conflict of interest, the policy calls for contracting authorities, before

> signing a contract, to require the selected consultant or professional to sign a declaration, either as part of the contract or separately, stating that no pecuniary interest in the business of any third party exists that would affect objectivity in carrying out the contract.
>
> There are also situations where, in meeting its obligations to a contracting authority, a contractor may be in a position of potential conflict with competing or opposing interests of the contractor's other clients, either during the period of or subsequent to this particular contract. Contractors are expected to inform the contracting authority of these potentially competing services and interests, and explain why the situation would not represent a conflict of interest. Where appropriate, . . . a contractor [is required] to sign a declaration [to that effect].

4.16 The Treasury Board Directive on Transfer Payments (including grants and contributions) addresses conflict of interest by stating that department managers who are responsible for preparing funding agreements must make sure that no current or former public servant or public office holder shall benefit, unless providing or receiving such benefits complies with the legislation and codes that apply.

The Secretariat plays an important role

4.17 Under the Values and Ethics Code, the Treasury Board, through its Secretariat, is responsible for several ongoing activities that support departments and agencies as they implement the code (Exhibit 4.2).

Exhibit 4.2 Responsibilities of the Treasury Board of Canada Secretariat

According to the Values and Ethics Code for the Public Service, the Treasury Board of Canada, through its Secretariat, must

- ensure that information and educational materials related to the Code are widely available;
- maintain an advisory support service for deputy heads and for designated officials on how to interpret and promote the Code;
- use the Management Accountability Framework to monitor the implementation of the Code in departments and agencies;
- assist deputy heads and public servants in determining whether their assets, such as publicly traded securities, could lead to a conflict of interest in relation to their duties and obligations and, if necessary, set up a **blind trust** or divest the assets; and
- conduct a review of the Code five years after it comes into effect.

Source: Information adapted from the government's Values and Ethics Code for the Public Service

A blind trust—A trust in which the trustees have full discretion over the assets, and the trust beneficiaries have no knowledge of the holdings of the trust and no right to intervene in the handling of the trust.

4.18 The Treasury Board of Canada Secretariat supports the President of the Treasury Board in promoting ethical practices in the public sector under the *Public Servants Disclosure Protection Act* (PSDPA). As the responsible central agency, the Secretariat's role is crucial in encouraging a shared understanding of the measures to avoid conflict of interest throughout the public service. We examined the Secretariat's role and responsibilities in relation to conflict of interest to find out how well the Secretariat was carrying out these responsibilities. We interviewed key Secretariat officials in the relevant policy areas and analyzed the information they provided.

4.19 The Office of Public Service Values and Ethics moved to the Public Service Human Resources Management Agency (later called the Canada Public Service Agency) in 2003, soon after the Values and Ethics Code was adopted. This Office developed basic guidance, including an interpretation guide for the Code and guidelines for setting up a blind trust.

4.20 The Office also gave departments and agencies other support tools. These tools included a website for values and ethics, material on "Frequently Asked Questions" and "Advice from the Experts," and a Guide to Action for senior officials designated under the Code. The Office offered outreach activities by convening values and ethics networks for department officials, including a network devoted to conflict of interest. The Office also launched training initiatives with the Canada School of Public Service.

4.21 The PSDPA requires the Treasury Board to establish a code of conduct for the public sector, which will apply to departments and agencies within the public service as well as to other public sector entities such as Crown corporations. This code is expected to replace the Values and Ethics Code for the Public Service. Departments and agencies will also be required to create their own codes of conduct, which are to align with the public sector code, by 31 March 2011. The Secretariat has told us that it intends to address conflict of interest in the new code; more detailed provisions will be contained in a new Treasury Board Policy on Conflict of Interest and Post-Employment for the core public administration.

The Secretariat is not providing sustained support to departments

4.22 At the time of our audit, the Secretariat had not finished developing the new code of conduct and the conflict of interest policy, both of which have been in development since the PSDPA came into force in 2007. The delays in issuing the new code and policy have added

to a sense of uncertainty in the audited departments. At the discretion of their deputy heads, some organizations have postponed developing their own codes of conduct until the public sector code is finalized, while others have proceeded to set up their own codes. For example, the Labour Program in Human Resources and Skills Development Canada took the initiative to release Guidelines of Professional Conduct in 2009.

4.23 In March 2009, the government consolidated the Canada Public Service Agency with sections of the Secretariat to form the Office of the Chief Human Resources Officer, returning the policy centre for values and ethics to the Secretariat. The government's objective for the consolidation was to simplify and streamline the roles of central human resource agencies and to enable deputy heads to take responsibility for human resource management in their own departments. As a result, staff resources for the policy centre were reduced, from 23 full-time equivalents (FTEs) in 2008 to 11 FTEs in early 2010.

4.24 Secretariat officials told us that as a result of resources being reduced and the mandate being changed from that of the former Office of Public Service Values and Ethics, they must now focus on key priorities, such as implementing the PSDPA and developing the new code of conduct and conflict of interest policy. Other activities that the 2003 code required have been limited.

4.25 For example, the code requires the Treasury Board to ensure, through its Secretariat, that information and educational material are made widely available. When consulted by the Secretariat, several departments identified the need for more detailed, up-to-date guides and tools to address their concerns with the interpretation of the code. Some of the audited departments have expressed the same concerns. In our view, the required materials are not sufficiently widely available.

4.26 The need for policy guidance was also raised by Natural Resources Canada (NRCan). Although it has not formally addressed this issue to the Secretariat, NRCan told us that it needs additional guidance from the Secretariat on conflict of interest situations that could arise from the its extensive external collaborations with universities and the private sector.

4.27 Although the Secretariat had developed draft guidance for departments and agencies on how to identify and manage their conflict of interest risks, the audited departments told us that they were not aware of this guidance. This guidance was to be released in the 2008–09 fiscal year. At the time of our audit, the guidance had not been finalized

or formally issued. Other tools remain out of date, including the confidential report form to declare conflicts of interest. Although this form is not mandatory, and departments can adapt it to suit their needs, the Secretariat has not revised it or its related instructions since 2003.

4.28 Recommendation. The Treasury Board of Canada Secretariat should work with deputy heads to identify the common needs of their departments and agencies in the areas of policy advice and guidance for conflict of interest, and should support deputy heads in meeting those needs.

The Secretariat's response. Agreed. While recognizing that deputy heads have primary responsibility for managing conflict of interest within their organizations, the Secretariat will work with deputy heads of departments and agencies subject to the new Policy on Conflict of Interest and Post-employment to identify common needs for guidance on the management of conflict of interest and methods for meeting those needs.

Common needs for training with content from the policy centre are not being met

4.29 The identification of common learning needs and central delivery of training programs can help ensure that departments and agencies have a common understanding of the rules that govern conflict of interest.

4.30 The Secretariat has recognized that departments and agencies need common training material, especially in relation to the development of their organizational codes of conduct and in applying the new Public Sector Code and Conflict of Interest Policy. The Secretariat can play a supporting role in encouraging organizations to identify common learning needs. We examined the Secretariat's activities in this area.

4.31 The Secretariat has told us that it does not have the mandate to provide conflict of interest training itself, and that deputy heads are solely responsible for identifying training needs for their employees and ensuring these needs are met. Deputy heads are assisted by the Canada School of Public Service in meeting the learning needs of their organizations, including training and development programs delivered by the School. No one body is responsible for developing common training for conflict of interest across the public service. In our view, the lack of sufficient training with content from the policy centre creates a risk that public servants across government will not have a common understanding of conflict of interest.

4.32 As in other areas, we found that work had been started by the Secretariat but had not been completed or fully implemented. A draft plan for ethics training was developed in 2005, but was not fully implemented. A course entitled "Conflict of Interest Practitioners' Training" was offered to values and ethics officers in departments in 2006, but only two pilot courses were given that year. Training for senior management includes a small component on conflict of interest, as part of the section on values and ethics.

4.33 An online values and ethics course for public servants, delivered by the Canada School, entitled "Paving the Way," which has a section on conflict of interest, has been available since 2008. Plans were under way to offer online training geared to managers as well. However, at the time of our audit, the development of the courses targeted to middle managers and senior managers had not been completed as planned.

4.34 **Recommendation.** The Treasury Board of Canada Secretariat should work with deputy heads to identify the common needs of departments and agencies for training that is related to conflict of interest, and should support deputy heads in meeting those needs.

The Secretariat's response. Agreed. While recognizing that deputy heads have primary responsibility for managing conflict of interest within their organizations, in partnership with the Canada School of Public Service, the Secretariat will work with deputy heads to identify the course material that should be modified or developed to respond to the coming into effect of the new Policy on Conflict of Interest and Post-Employment.

The Secretariat has reviewed the effectiveness of the Values and Ethics Code

4.35 The Values and Ethics Code states that the Secretariat must monitor how departments implement the code by using the Management Accountability Framework (MAF) and conducting a five-year review of the code itself. The Secretariat has said that one of its goals in revising policy instruments is to ensure that they respond adequately to key risks in a cost-effective way. These instruments include the guidance and other tools that the Secretariat creates to help departments implement policy. We examined the efforts the Secretariat has made to monitor and assess the effectiveness of these tools.

4.36 The Secretariat monitors the implementation of the Values and Ethics Code in departments and agencies through its annual MAF exercise, which began in 2003. One of the "areas of management" in the MAF focuses on values and ethics; however, we found that the

assessments do not specifically examine conflict of interest. In our view, referring to conflict of interest would ensure that this area is assessed more completely. We noted that the issues raised in the MAF vary from year to year, which gives the Secretariat an opportunity to improve the assessments by including conflict of interest in future MAF rounds.

4.37 The Values and Ethics Code calls for a five-year review, which came due in 2008. Secretariat officials told us that the review began with research and consultations with the community of interested officials in departments and agencies. The review was later merged with the policy work to develop the Code of Conduct that was required under the *Public Servants Disclosure Protection Act*. We noted that the consultations identified departments' concerns, comments, and suggestions on conflict of interest; this input enabled the Secretariat to learn what changes were needed and to assess policy effectiveness. Although its review did not include its current guidance tools and support activities, we noted that the Secretariat plans to issue revised guidance when the new policy is developed.

Implementation of conflict of interest measures in selected departments

4.38 We examined the conflict of interest frameworks that are in place at Agriculture and Agri-Food Canada (AAFC), Canadian Heritage, Human Resources and Skills Development Canada (HRSDC), Natural Resources Canada (NRCan), and Public Works and Government Services Canada (PWGSC). Exhibit 4.3 provides information on the mandates, spending levels, and number of employees in each department.

The departments have the required mechanisms in place to address conflict of interest

4.39 Deputy heads have major responsibilities under the Values and Ethics Code. They are responsible for ensuring that public servants comply with the code and must set rules governing conflict of interest in their organizations. We examined whether departments had adequate mechanisms to address conflict of interest—including methods for public servants to comply with the code, organizational arrangements, and guidance.

4.40 We found that the selected departments have met the Values and Ethics Code's requirements to have mechanisms in place to address conflict of interest and have determined what, in their view, are appropriate methods for public servants to comply with the code to avoid conflicts of interest. All five departments give a copy of the code

to public servants with the letter of offer, on appointment, as required in the code. Four of the departments remind staff once a year that they must submit confidential reports on conflict of interest if they find themselves in such a situation. At the time of our audit, NRCan did not have this measure in place.

4.41 PWGSC made it mandatory for public servants who are engaged in or who are considering any outside employment, including ownership of a business, to disclose this information in a confidential report, whether or not the public servant thinks that the situation may be a conflict of interest.

4.42 HRSDC told us that all public servants must now submit declarations within 60 days of their appointment, transfer, or deployment, or indicate they have nothing to disclose. HRSDC tracks public servants and checks whether they have submitted these

Exhibit 4.3 The audited departments have different mandates and risks

Departments	Mandate	Actual spending 2008–09 ($ million)	Number of full-time equivalents (employees)
Agriculture and Agri-Food Canada	Provide information, research and technology, and policies and programs to achieve security of the food system, health of the environment, and innovation for growth. This includes supporting agricultural productivity and trade, delivering farm income stabilization programming, and conducting research.	2,586	6,385
Canadian Heritage	Fund programs and provide grants and contributions to Canadians to promote culture; the arts; heritage; official languages; citizenship and participation; and Aboriginal, youth, and sport initiatives.	1,394	2,384
Human Resources and Skills Development Canada	Develop and manage programs and services to provide income support to Canadians through Old Age Security, the Canada Pension Plan, and Employment Insurance. Provide access to employment programs and services to unemployed Canadians to help them prepare for, find, and retain employment. Ensure safe, fair, and productive workplaces and effective international labour standards.	88,264	23,778
Natural Resources Canada	Conduct research and provide grants and contributions to Canadians for research and development to improve economic competitiveness, environmentally responsible use, and strengthened stewardship of Canada's natural resources.	4,678	4,372
Public Works and Government Services Canada	Provide procurement services for other government departments; make payments for, and accept payments to, the Government of Canada; manage a large and diverse portfolio of real estate; and provide information management/information technology (IM/IT) infrastructure for federal government operations.	2,459	14,379*

*Number of employees (not full-time equivalents)

Sources Departmental performance reports 2008–09 and departmental websites

declarations, and it is developing an automated process to facilitate this practice. The new requirement is posted on the HRSDC intranet; however, at the time of our audit, there had not been a department-wide announcement about the requirement. The practice of requesting all public servants to submit a declaration, although not required by the Values and Ethics Code, is useful for providing assurance to department management that all staff have considered and addressed the issue.

4.43 The five departments have put in place organizational units to deal with values and ethics. All have designated a senior official "to assist public servants to resolve issues arising from the application of the code." The departments have also designated a senior officer for disclosure, as required by the *Public Servants Disclosure Protection Act*. All of the selected departments have senior-level "champions" for values and ethics apart from the senior official with direct responsibility for values and ethics, although they are not required to. We interviewed the officials in all three of these positions in the five departments and found that they were knowledgeable about their role.

4.44 The five departments also have mechanisms and assistance for public servants to discuss issues related to the code. These practices include listing information on their intranets about conflict of interest and about how to declare a conflict of interest. The departments have listed contact names, phone numbers, and email accounts so public servants can reach staff who can answer their questions. AAFC gives all managers a copy of its Conflict of Interest Reference Guide, which contains detailed guidance on conflict of interest procedures, roles, and responsibilities. The guide offers managers the background they need to deal with conflict of interest situations and questions that could arise. Canadian Heritage gives public servants a guide to help them avoid conflict of interest in two areas: taking part in outside activities or employment, and accepting complimentary tickets to cultural or sporting events.

4.45 Departments must also discuss values and ethics in their external audit advisory committees. The Treasury Board Directive on Departmental Audit Committees, which took effect in 2006, requires that these committees periodically review compliance with ethical standards, including conflict of interest. We examined the proceedings of these audit committees and found that all had addressed values and ethics in at least one of their meetings over the past three years.

4.46 Overall, the audited departments have developed mechanisms to meet the requirements of the Values and Ethics Code and, in some

cases, have developed additional mechanisms. However, there are a number of areas that require further attention.

Processing of conflict of interest declarations is inconsistent and often not timely

4.47 Once departments receive conflict of interest declarations, they must analyze them to identify issues, judge how serious the issues are, take action in a timely manner, and verify that the conflict has been resolved. If it is not resolved, the department is responsible for imposing sanctions. We examined the processes departments use to deal with confidential reports to make sure that the conflict was mitigated or resolved in each case. We also carried out a file review relating to conflict of interest declarations by individuals at NRCan, Canadian Heritage, and PWGSC to determine if key steps were followed, appropriate parties were involved, and the process was timely.

4.48 In our file review, we found that the departments we examined followed a process that included consultation with the individual involved and often with the individual's manager and with legal services. The departments analyzed the situation and decided on action to be taken by the public servant, if warranted. In most cases, the individual was sent a written response within three months that outlined the action required to resolve the conflict of interest (for example, divesting himself or herself of certain assets).

4.49 However, we found inconsistencies in how departments follow up with public servants. With the exception of Canadian Heritage, the departments require public servants to provide proof that they have taken action to correct the situation. Once the letter outlining the recommended action has been received, Canadian Heritage relies on the individual (and, when required, on managers) to take action. Canadian Heritage has confirmed that it does not conduct further follow-up. Follow-up is needed to assure management that the public servant has taken action to reduce or eliminate the conflict of interest.

4.50 Timeliness was also an issue. Our file review found that in 11 cases out of 25, the process took more than 120 days. In our view, this is a long period of time for a department to operate with this type of uncertainty. Where it was clear that there was no conflict of interest, the files were processed quickly. Where the issue was more complex, it often took longer. In three of those cases, the individual left a department before the issue was resolved. This means that, in the interim, a serious conflict of interest could have been left unaddressed, creating a risk for the department. In October 2009, PWGSC officials

put in place a standard intended to process all files within 90 days to avoid this type of risk.

4.51 Recommendation. Agriculture and Agri-Food Canada, Canadian Heritage, Human Resources and Skills Development Canada, and Natural Resources Canada should put in place standards to ensure that conflict of interest declarations are addressed in a timely fashion, and that public servants take the required action to eliminate or reduce the conflict of interest.

Agriculture and Agri-Food Canada's response. Agreed. A review of the Values and Ethics Policy Centre activities has been completed. Service standards are being developed. In October 2010, the service standards will be communicated to employees, and performance against the standards will be tracked from that date.

Canadian Heritage's response. Agreed. The Department plans to determine and communicate a service standard to respond to conflict of interest enquiries by including the standard in the Human Resources Workplace Management Branch service standard document on the intranet site. It also plans to establish a follow-up system, with deadlines, if, in response to a potential conflict of interest, recommended actions must be taken by either the employee or management. The target date for these activities is October 2010.

Human Resources and Skills Development Canada's response. Agreed. The Department is taking corrective measures to address this observation. The Department is currently developing a standardized process, including service standards, which will ensure conflict of interest declarations are addressed in a timelier manner in the future. In addition, a "bring forward" administrative system will be implemented to ensure required action is taken by public servants to appropriately mitigate any areas of identified conflict of interest. A phased approach will be used to implement these standards by the target date of 31 December 2010.

Natural Resources Canada's response. Agreed. The Department has recently launched a Values and Ethics Program Framework built around five pillars: leadership, outreach, policies and procedures, guidance and advice, and oversight. This framework, along with the Department's Corporate Risk Framework, is providing policy guidance, context, and coordination for departmental priorities and action related to conflicts of interest, including the management response to this audit.

Consistent with the five pillars, the Department regularly advises on declaration obligations, most recently on 29 June 2010, and will

continue to do so on an annual basis. The Department will also be establishing service standards to ensure that such declarations are addressed on a timely basis, with a target date of 31 December 2010 for establishing these service standards.

Mechanisms address situations of conflict of interest that we identified in previous audits

4.52 Our previous audits that identified cases of conflict of interest focused on two areas: grants and contributions, and procurement. We examined the actions that AAFC, NRCan, and PWGSC had taken to prevent these types of situations from happening again. We looked at whether measures are in place and whether they are designed to address the issues identified; however, we did not audit how well the measures are working. We found that mechanisms had been put in place that are intended to address these areas.

4.53 **Grants and contributions.** Our 2007 audit of AAFC recommended that the Department strengthen measures to reduce the risks of conflict of interest where public servants who process farm income support applications also help to prepare applications for themselves and others. We found that AAFC has taken action in response to our chapter and to recommendations from the Public Accounts Committee to avoid conflict of interest issues in its farm income support program.

4.54 AAFC now includes clauses in application materials that require public servants who process farm income support applications to declare that they have no conflict of interest. Public servants are told not to help applicants fill out application forms for a fee; public servants and former public servants must identify themselves when filling out applications to receive income support for themselves or others; and a special team has been created to process applications from present or former public servants at AAFC to ensure impartiality. Conflict of interest training is now mandatory for staff working in all grant and contribution programs.

4.55 In Chapter 6 of our 2009 Spring Report, we recommended that NRCan create policies and guidance to identify and address conflicts of interest for contribution agreements. We found that NRCan has put in place a new transfer payment policy, which includes a 20-point checklist for contribution agreements. Staff must sign the policy to say they understand what to do to avoid and disclose conflicts of interest for each agreement. We noted that three conflict of interest clauses are now in all contribution agreements. These clauses require those who

administer the agreement to identify, prevent, and resolve conflicts of interest. In an April 2010 report, the Public Accounts Committee recommended that NRCan take further measures to ensure it has the right mix of policies, procedures, and practices to manage grant and contribution programs appropriately and to make sure that problems involving contribution agreements do not happen again.

4.56 **Procurement.** PWGSC is the federal government's main department for procurement. Our 2008 audit recommended that PWGSC take steps to avoid situations of conflict of interest, such as awarding a contract to an individual or firm that helped to develop the search criteria. The Public Accounts Committee recommended that PWGSC review its contracting policy for long-term information technology projects, including issues that could lead to employee–employer relationships being created. PWGSC submitted, to the Public Accounts Committee, an action plan that included developing an overall Contract Management Framework. A key part of the framework is a form that requires members of bid evaluation teams to certify that being on the team is not a conflict of interest for them. However, we did not audit the implementation of this measure.

The departments do not adequately identify potential risks for conflict of interest

4.57 The Values and Ethics Code requires deputy heads to discuss values and ethics "in a manner that is relevant to the specific issues and challenges encountered by their organizations." To achieve this goal, departments must examine their activities, programs, and functions to identify areas where the possibility of conflict of interest is greater, and devise strategies to address these situations. We examined related documentation in each department and spoke to department officials about whether these actions were carried out.

4.58 In departments where we had found instances of conflict of interest before, we noted that strategies had been developed to assess specific areas; however, at the time of our audit, none of the selected departments had examined all areas of their organization to identify risks of conflict of interest. As noted previously, the Secretariat has developed draft guidance on identifying and managing conflict of interest risks, but has not yet finalized or formally released this guidance.

4.59 PWGSC's guidance on conflict of interest focuses on outside employment and post-employment, as well as relationships with consultants and suppliers, but not on other areas. To address this, PWGSC officials informed us that they are developing a department-wide operational risk profile that identifies other types of conflict of

interest that could arise. However, at the time of our audit, this was not yet finalized.

4.60 Canadian Heritage conducted a formal risk assessment in the 2008–09 fiscal year that rated conflict of interest as a low risk. This finding was based on the fact that it had guidance in place on accepting gifts and taking part in outside activities or employment, and had strong ratings for values and ethics in the Secretariat's Management Accountability Framework. This assessment, however, did not consider the risk of conflict of interest in all Canadian Heritage programs and functions, notably grants and contributions—one of its key activities.

4.61 Both NRCan and AAFC have taken steps to assess risks for conflict of interest in some of their activities. However, the departments have not systematically assessed other areas that may have posed risks. At the time of our audit, both of these departments were working to identify areas of risk for conflict of interest in all their programs, but this work is not yet complete. NRCan has noted that because of its science mandate, collaboration both within and outside government is needed. Identifying risks of conflict of interest in collaborative arrangements is important for this department, leading it to seek guidance from the Secretariat.

4.62 HRSDC's corporate risk profile does not yet address conflict of interest; however, we noted that it was working on a Values and Ethics Risk Assessment. This document is intended to address risks for conflict of interest in areas including grants and contributions and contracting.

4.63 Without an understanding of where risk lies, federal departments cannot help public servants guard against it. While the audited departments have made efforts to assess risks of conflict of interest in specific areas, each organization needs a comprehensive and consistent approach. Part of this approach involves requiring public servants in high-risk areas to submit a declaration regularly, even if they have no conflict of interest to declare. This type of positive declaration can provide assurance to departments that public servants in high-risk areas have thought about conflict of interest and have addressed it.

4.64 Recommendation. Agriculture and Agri-Food Canada, Canadian Heritage, Human Resources and Skills Development Canada, Natural Resources Canada, and Public Works and Government Services Canada should develop an approach to risk assessment that includes identification and prioritization of risks, assessment and mitigation strategies, and residual risk assessment, in the key areas where major conflicts of interest could arise.

Agriculture and Agri-Food Canada's response. Agreed. The Department has completed a risk assessment for conflict of interest for 2010. It will use lessons learned from this process, along with any direction and guidance from the Treasury Board of Canada Secretariat on assessing conflict of interest risk, in future assessments.

Canadian Heritage's response. Agreed. By March 2011, the Department will develop an approach to perform a risk assessment that will identify key areas where major conflicts of interest could arise. The Department will also ensure that the risk assessment results are confirmed on a regular basis, as required.

Human Resources and Skills Development Canada's response. Agreed. The Department has conducted a preliminary department-wide risk assessment of values and ethics to validate key areas where major conflicts of interests could arise. Building on the results of the preliminary assessment, the Department will conduct further analysis to identify areas of high risk. Risks identified will be prioritized, and appropriate risk mitigation strategies will be developed to address each risk. Key deliverables and timelines for completion of those deliverables will be identified, and indicators to measure success of each risk mitigation strategy will be established. Finally, implementation of these strategies will be monitored and modified when necessary, with planned progress reporting on a bi-annual basis to senior management through corporate committees. A target date of March 2012 has been set for implementing this enhanced risk assessment and related strategies.

Natural Resources Canada's response. Agreed. As noted in this report, the Department has taken steps to assess risks for conflict of interest. It has launched a corporate risk profile, which is a departmental risk assessment process, to identify, assess, and prioritize corporate-level risks and mitigation strategies. This will include but is not limited to conflict of interest. The corporate risk profile clarifies governance and accountabilities, and fosters employee engagement, training, and risk awareness. The Department will build on this work to more fully and systematically assess potential risk areas.

Specifically, through the Values and Ethics Program Framework and its corporate risk profile, the Department has identified its transfer payment (grant and contribution) programs as the highest conflict of interest risk area. The Department has established a Centre of Expertise in the Human Resources Branch for Values and Ethics and identified a Values and Ethics Champion at the assistant deputy minister level. The Department's Values and Ethics Champion,

managers, and the Centre of Expertise provide advice and guidance to eliminate or reduce conflict of interest. Additionally, the Department added three conflict of interest clauses to its contribution agreements to avoid conflict of interest situations involving employees and recipients.

The second conflict of interest priority risk area for the Department is Science and Technology (S&T). An S&T Conflict of Interest Working Group was created and mandated through established terms of reference to focus its efforts in assessing the Department's needs, elaborate relevant working tools, and provide direction on S&T collaboration. Working Group recommendations will be fully implemented by the end of the 2010–11 fiscal year.

The third conflict of interest priority area for the Department is contracting and human resources services. By 31 March 2011, the Department will establish guidelines regarding the hiring of former public servants.

Public Works and Government Services Canada's response. Agreed. The Department has developed a robust approach to risk assessment that includes identification and prioritization of risks; assessments and mitigation strategies; and residual risk assessment. The Department's draft operational risk profile will be finalized by the end of December 2010 and will pay special attention to risks relating to conflict of interest. The Department will use the operational risk profile to refresh its corporate, branch, and regional risk profiles. In addition, the Department will revise the risk categories annex of its Policy on Integrated Risk Management to include conflict of interest risks. It will include these risks in the Department's Risk Management Guide, as well as the training courses for its executives (half-day training session) and for managers and supervisors (one-day session).

4.65 Recommendation. Once they have identified high-risk areas through an appropriate risk assessment process, Agriculture and Agri-Food Canada, Canadian Heritage, Human Resources and Skills Development Canada, Natural Resources Canada, and Public Works and Government Services Canada should require public servants in identified high-risk areas to report regularly, whether or not they have a conflict of interest.

Agriculture and Agri-Food Canada's response. Agreed. Once the Department has identified its areas at high risk for conflict of interest, it will implement a process where public servants occupying high risk

positions in those areas attest regularly that they understand their obligations under the Values and Ethics Code for the Public Service and indicate whether or not they need to submit or update their Confidential Report. Phased implementation will begin in April 2011 in conjunction with the implementation of the new Values and Ethics Code for the Public Service.

Canadian Heritage's response. Agreed. Once the Department has identified its areas at high risk for conflict of interest, it will implement a new reporting process. Public servants occupying high risk positions will be required to attest regularly that they understand their obligations under the Values and Ethics Code for the Public Service. They will also be required to indicate whether or not they need to submit or update their confidential declaration. The target date for these activities is June 2011.

Human Resources and Skills Development Canada's response. Agreed. In addition to conducting a robust risk assessment exercise as outlined in the Department's response to the previous recommendation, the Department has initiated the development of an automated confidential report submission process for attestations by its employees. When fully implemented, this process will complement the enhanced risk-assessment exercise currently underway. The attestation will also include a declaration as to whether information submitted in previous confidential report submissions provided to the Department needs to be re-submitted or updated. The target date for launching the pilot phase of the automated confidential report submission system is September 2010. The target date to automate the attestation process for individuals working in identified high risk areas is April 2011.

Natural Resources Canada's response. Agreed. The Department's Values and Ethics Program Framework includes the implementation in 2010–11 of a process where public servants in high risk positions attest regularly as to whether they are in a situation that could present a conflict of interest. As per the Values and Ethics Code for the Public Service, employees faced with conflict of interest situations are required to submit a confidential report, which is then assessed by the Department's Values and Ethics Centre of Expertise. As appropriate, an action plan is developed and implemented to mitigate risks.

Public Works and Government Services Canada's response. Agreed. Once the Department has identified its areas at high risk for conflict of interest, it will implement a reporting process. Public servants occupying positions in those high risk areas will be required to attest, at an interval appropriate to the risk exposure, that they

understand their obligations under the Values and Ethics Code for the Public Service. They will also indicate whether or not they need to submit or update their confidential declaration.

The departments offer some training in conflict of interest

4.66 Training is critical to promote awareness of situations that could lead to conflict of interest. With proper training, public servants can detect, disclose, avoid, or resolve such situations before they become problems for the department. Guidance on the Values and Ethics Code states that departments have a responsibility to offer public servants awareness training, and educational activities and materials. The code also states that this training should be relevant to the specific issues and challenges of departments, as training that relates closely to the work of public servants is more likely to be effective. We examined whether departments offered training on conflict of interest, whether it was mandatory, whether it included discussion of scenarios specific to the department, and whether effectiveness was assessed. We looked at course information, course materials, and training statistics. We also met with the people who designed and delivered the training.

4.67 We found that AAFC has identified training needs and implemented a mandatory course that deals specifically with conflict of interest. The course includes a discussion of scenarios and case studies that reflect conflict of interest risks that are specific to AAFC activities, programs, functions, and levels of employees. AAFC also has a conflict of interest reference guide that enables managers to deliver additional training to employees. Orientation courses for new employees and managers include a conflict of interest component.

4.68 At Canadian Heritage, all new employees receive an orientation session that includes values and ethics. Managers also attend a mandatory two-day session that includes content on values and ethics. The 2009 Canadian Heritage grants and contributions training event featured a session on values and ethics, which included case studies.

4.69 PWGSC also provides mandatory training in ethics for all public servants. The one-day course includes several case studies that deal with conflict of interest issues. PWGSC provides ad hoc information sessions to public servants at the request of management after a particular incident or based on certain identified risks. HRSDC's orientation for new employees incorporates values and ethics components. Different branches and groups can request training in values and ethics when they need it.

4.70 NRCan does not have mandatory training, but has provided some sessions to groups of employees that include case studies based on the its activities. While all five departments used some end-of-session feedback to improve future training, none held a formal evaluation of how effective the training was.

4.71 Although the audited departments offer a wide range of training, with the exception of AAFC, this training is not based on efforts by the departments to identify areas where conflict of interest could arise. Creating an approach based on cases and scenarios that reflect the unique conflict of interest risks that different groups of staff face as they carry out their duties would help participants to understand better the conflict of interest situations they could face and to learn the best way to address them.

4.72 Recommendation. Canadian Heritage, Human Resources and Skills Development Canada, Natural Resources Canada, and Public Works and Government Services Canada should ensure that their training is based on the conflict of interest risks that staff in specific areas face as they carry out their duties; the training should include case studies and scenarios in these areas.

Canadian Heritage's response. Agreed. From April 2011, the Department will ensure that conflict of interest training and/or awareness sessions that it provides are based on risk areas identified within the risk assessment and include cases and scenarios related to these areas.

Human Resources and Skills Development Canada's response. Agreed. The Department recognizes the benefit of developing training that takes into consideration conflict of interest risks that staff in specific areas face as they carry out their duties. The Department further recognizes that improvements can be made to the values and ethics training program it currently has in place, and it will take steps to do so. More specifically, the Department's Office of Values and Ethics, in partnership with Human Resources Services Branch and the Service Canada College, is currently developing training material on conflict of interest to inform employees on avoidance, prevention, and resolution of conflict of interest situations.

Further, plans are being developed to ensure that orientation sessions for new employees include realistic case studies, scenarios that new employees would be expected to encounter day to day, and practical strategies for resolution. A draft tool entitled Practical Solutions for Public Servants, designed to assist public servants make ethical

decisions, assess post-employment situations, and determine situations that could give rise to conflict of interest, is also being tested. Testing is expected to continue until January 2011, when the Department will determine rollout and implementation.

Finally, the Department will continue to use the intelligence gained from other activities (for example, Special Investigations Unit outcomes) to ensure its training continues to focus on risk areas specific to its mandate.

Natural Resources Canada's response. Agreed. The Department's Values and Ethics Program Framework includes conflict of interest employee training. The Department has achieved increasing levels of values and ethics awareness and understanding among managers and employees across the Department. For example, it holds employee engagement sessions, including case studies that address values and ethics as well as conflict of interest situations and appropriate responses. These case studies are and will continue to be updated to ensure they reflect realistic and specific situations related to risks that may be encountered.

The Department's key values and ethics activities planned for the 2010–11 fiscal year include the following:

- leadership and employee engagement;
- outreach and partnering with the Department's communities of practice and with social media technologies, developing a departmental code of conduct;
- policies, procedures, and processes to address the Department's needs (for example, establish service standards to address conflict of interest issues);
- guidance and advice to ensure awareness of and conformity to the values and ethics code (guidelines for gifts, hospitality, and other benefits); and
- oversight (monitoring and evaluation) of the values and ethics program's effectiveness and efficiency (for example, assessing the Department's ethical climate through an internal survey).

Public Works and Government Services Canada's response. Agreed. The Department is offering training that includes cases and scenarios developed and geared directly toward certain risks identified within a particular area of the Department's operations. For example, the training provided to Parliamentary Precinct Branch employees in May and June 2009 included scenarios for discussion geared to the

types of contracting conducted within the branch. Similar training based on identified risks was also delivered within other areas of the Department in November 2009 and March 2010. Once the risks in key areas where major conflicts of interest could arise have been identified and prioritized, the Department will review its training program to ensure the program is based on the conflict of interest risks that staff in specific areas could face as they carry out their duties. The Department will also ensure that its updated training program includes relevant cases and scenarios, where appropriate.

The departments are taking some steps to assess the effectiveness of their conflict of interest measures

4.73 The Values and Ethics Code makes deputy heads accountable for ensuring that the Code is fully upheld and advanced in their organization. They are also responsible for monitoring and auditing to see whether public servants comply with the code. To meet these responsibilities, deputy heads must find out whether the measures that are in place are effective. We examined how the five audited departments assessed how effective their methods are for avoiding conflict of interest.

4.74 We found that the departments have collected and analyzed information on how adequate their conflict of interest measures are. In 2007, HRSDC did an audit of its ethics infrastructure that recommended that cases to identify trends and root causes of ethical transgressions be analyzed and that action be taken to prevent further occurrences. HRSDC has tried to centralize the tracking of confidential reports. It has not been able to provide complete data on confidential reports because some information has been kept at the regional level. Data on inquiries about values and ethics is tracked separately by a different branch and does not cover conflict of interest declarations.

4.75 A 2009 evaluation of values and ethics that PWGSC conducted found that despite signs that the program is working well, the evaluation was unable to assess the program's impact thoroughly due to the lack of effective, results-based measurement of performance. The evaluation recommended that a performance measurement strategy be developed to assess effectiveness and track performance. PWGSC is implementing a plan to address the evaluation's recommendations. It has also set a service standard of a maximum of 90 days to analyze a confidential report on a conflict of interest and respond to the public servant who submitted it. The Deputy Minister receives quarterly information on conflict of interest cases that have not been resolved within 90 days, as well as

information on ethical enquiries, which may include questions related to conflict of interest. However, this data does not include all data on conflict of interest, such as the total number of outstanding cases.

4.76 NRCan conducted an internal audit in 2009 that measured progress on values and ethics activities since 2005. The audit recommended that mechanisms be implemented to monitor and measure the results of the NRCan values and ethics program. NRCan also analyzed the values and ethics elements of the 2008 Public Service Employee Survey for its own employees.

4.77 AAFC has tracked the frequency of different types of conflict of interest queries and self-declarations. It noted that these communications increased after public servants received awareness sessions and annual reminders. It also noted that the types of situations reported in self-declarations suggest that public servants now have a greater understanding of what a conflict of interest could be.

4.78 Canadian Heritage and HRSDC referred to their ratings on the values and ethics section of the Management Accountability Framework (MAF) as one way to assess how effective their efforts are in addressing conflicts of interest. We noted, however, that the MAF questions on values and ethics were not directly focused on conflict of interest.

4.79 The audited departments have taken some steps toward monitoring and assessing how effective their efforts are in this area. They have collected and analyzed data and have carried out program evaluations and internal audits. However, the approach has not been systematic. Such an approach would involve identifying desired outcomes, developing valid and reliable measures, establishing a baseline, and setting targets for improvement. In particular, the departments could make greater use of employee surveys. These and other measurement instruments are used in other jurisdictions and in the private sector to assess how effective methods are for helping employees avoid conflict of interest.

Conclusion

4.80 Avoiding situations that could lead to a conflict of interest—or the appearance of a conflict of interest—is key to maintaining public confidence in the impartiality and objectivity of the public service. The three cases of conflict of interest that we examined in previous audits showed that certain elements for addressing conflicts of interest could be missing in the frameworks in departments. Our audit set out to

determine whether the Treasury Board of Canada Secretariat and five selected departments gave public servants the tools they needed to meet federal government responsibilities for addressing conflict of interest.

4.81 We found that while the Secretariat plays an important role related to conflict of interest, in our view it has not provided sustained support. Two areas that have suffered are guidance and training. Also, at the time of our audit, the new Code of Conduct and Conflict of Interest Policy were not yet in place, even though work on these documents began in 2007.

4.82 In the departments we audited, we found that the required mechanisms and assistance were in place for managing conflict of interest, and that designated senior officials have enough knowledge to meet their responsibilities for managing conflicts of interest. Departments have set up organizational units, designated senior positions, and given guidance and training to meet their obligations. They have put in place processes to deal with conflict of interest declarations, but need to follow up on required action and make sure that conflict of interest declarations are dealt with in a timely manner.

4.83 The three departments where we had found instances of conflict of interest in previous audits have addressed risks in the specific areas we audited. All of the departments we looked at have begun to appreciate the need to examine their entire organizations to identify the programs and functions where conflict of interest is likely to occur, so that they can avoid or reduce it in these areas.

4.84 To prevent serious cases of conflict of interest, the Secretariat needs to continue to support departments and agencies in identifying and managing serious cases of conflict of interest. This support will help departments to analyze risks and assess how effective their efforts are in this area. This collaboration is key to ensuring that issues are detected and addressed as early as possible, ideally before any wrongdoing can occur, and to preserving the credibility of the Canadian public service.

About the Audit

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by The Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

Objectives

The objectives of this audit were to determine

- whether the Treasury Board of Canada Secretariat provides the tools that departments need to meet federal government conflict of interest responsibilities, and
- whether the five selected departments have ensured that mechanisms and assistance are in place and that designated senior officials have enough knowledge to meet their responsibilities on the issue of conflict of interest.

Scope and approach

The audit examined conflict of interest policies, controls, mechanisms, and frameworks. We also examined how thoroughly the Secretariat and the departments have assessed the effectiveness of their conflict of interest activities. We looked at the knowledge levels of selected officials who have responsibilities for conflict of interest—generally, senior public servants at the executive level, including assistant deputy ministers. Three of the departments we examined—Agriculture and Agri-food Canada (AAFC), Natural Resources Canada (NRCan), and Public Works and Government Services Canada (PWGSC)—were selected because we found cases of conflict of interest in our recent audits. We added two other departments to our selection: Canadian Heritage, as an example of a small department focused on issuing grants and contributions, and Human Resources and Skills Development Canada (HRSDC), as an example of a department with a high dollar value of contracts and of grants and contributions. While we examined the frameworks in place in the departments, we did not audit individual cases.

The scope did not include ministers or other members of Parliament, officials appointed by the Governor in Council, lobbyists, or Crown corporations.

Our audit work included interviews with the Secretariat policy centre for values and ethics and with Secretariat officials in Procurement, Grants and Contributions, and Risk Management. We conducted interviews with values and ethics staff and other conflict of interest staff in the five departments. We also conducted structured interviews with 15 senior officials in the departments (senior designated officials for values and ethics, senior disclosure officers, and values and ethics champions). The goal of these interviews was to obtain information on the roles and responsibilities of these positions, determine their level of knowledge of conflict of interest responsibilities, and obtain views on the tools departments needed to meet their conflict of interest responsibilities. We used the same questions in each case to enable comparison.

We reviewed the Secretariat's and departments' documentation relating to conflict of interest and conducted a file review of 25 randomly selected files in three departments (5 from Canadian Heritage, 10 from NRCan, and 10 from PWGSC) to examine the process used to address specific conflict of interest declarations. We did not generalize from the three samples to their parent populations; accordingly, all the findings we report are based on these 25 sampled files.

We also reviewed the minutes and reports of the House of Commons Public Accounts Committee relating to our previous chapters that found cases of conflict of interest. Finally, to help inform our recommendations, we conducted research on the conflict of interest frameworks and guidance that are used in the Organisation for Economic Co-operation and Development, the Ontario and British Columbia governments, Australia, New Zealand, the United Kingdom, and two private sector companies.

Criteria

To determine whether the Treasury Board of Canada Secretariat provides the tools departments need to meet federal government conflict of interest responsibilities, we used the following criteria:	
Criteria	**Sources**
The Secretariat has in place policies, guidance, and other tools to meet its responsibilities for conflict of interest.	• *Financial Administration Act*, sections 7, 80, 81 • Foundation Framework for Treasury Board Policies • Treasury Board of Canada Secretariat Management Accountability Framework Criteria
The Secretariat assesses the effectiveness of its policies, guidance, and other tools for conflict of interest.	Values and Ethics Code for the Public Service
To determine whether the five selected departments have ensured that mechanisms and assistance are in place and that designated senior officials have enough knowledge to meet their responsibilities on the issue of conflict of interest, we used the following criteria:	
Criteria	**Sources**
The audited departments have adequate mechanisms and assistance to meet their conflict of interest responsibilities.	Values and Ethics Code for the Public Service
The audited departments have appropriate guidance and training on conflict of interest.	• Values and Ethics Code for the Public Service • Treasury Board of Canada Secretariat Integrated Planning Guide
The audited departments monitor the effectiveness of their conflict of interest activities.	Foundation Framework for Treasury Board Policies
The designated senior officials in the audited departments have sufficient knowledge of what constitutes conflict of interest and how it should be addressed in order to meet their responsibilities for conflict of interest.	Values and Ethics Code for the Public Service

Management of the selected entities reviewed and accepted the suitability of the criteria used in the audit.

Period covered by the audit

The period under audit was three fiscal years: 2007–08, 2008–09, and 2009–10. We chose this period so we could examine conflict of interest over a span of several years. Audit work for this chapter was substantially completed on 31 May 2010.

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Appendix List of recommendations

The following is a list of recommendations found in Chapter 4. The number in front of the recommendation indicates the paragraph where it appears in the chapter. The numbers in parentheses indicate the paragraphs where the topic is discussed.

Recommendation	Response
Role of the Treasury Board of Canada Secretariat	
4.28 The Treasury Board of Canada Secretariat should work with deputy heads to identify the common needs of their departments and agencies in the areas of policy advice and guidance for conflict of interest, and should support deputy heads in meeting those needs. **(4.22–4.27)**	**The Secretariat's response.** Agreed. While recognizing that deputy heads have primary responsibility for managing conflict of interest within their organizations, the Secretariat will work with deputy heads of departments and agencies subject to the new Policy on Conflict of Interest and Post-employment to identify common needs for guidance on the management of conflict of interest and methods for meeting those needs.
4.34 The Treasury Board of Canada Secretariat should work with deputy heads to identify the common needs of departments and agencies for training that is related to conflict of interest, and should support deputy heads in meeting those needs. **(4.29–4.33)**	**The Secretariat's response.** Agreed. While recognizing that deputy heads have primary responsibility for managing conflict of interest within their organizations, in partnership with the Canada School of Public Service, the Secretariat will work with deputy heads to identify the course material that should be modified or developed to respond to the coming into effect of the new Policy on Conflict of Interest and Post-Employment.

Recommendation	Response
Implementation of conflict of interest measures in selected departments	
4.51 Agriculture and Agri-Food Canada, Canadian Heritage, Human Resources and Skills Development Canada, and Natural Resources Canada should put in place standards to ensure that conflict of interest declarations are addressed in a timely fashion, and that public servants take the required action to eliminate or reduce the conflict of interest. **(4.47–4.50)**	**Agriculture and Agri-Food Canada's response.** Agreed. A review of the Values and Ethics Policy Centre activities has been completed. Service standards are being developed. In October 2010, the service standards will be communicated to employees, and performance against the standards will be tracked from that date. **Canadian Heritage's response.** Agreed. The Department plans to determine and communicate a service standard to respond to conflict of interest enquiries by including the standard in the Human Resources Workplace Management Branch service standard document on the intranet site. It also plans to establish a follow-up system, with deadlines, if, in response to a potential conflict of interest, recommended actions must be taken by either the employee or management. The target date for these activities is October 2010. **Human Resources and Skills Development Canada's response.** Agreed. The Department is taking corrective measures to address this observation. The Department is currently developing a standardized process, including service standards, which will ensure conflict of interest declarations are addressed in a timelier manner in the future. In addition, a "bring forward" administrative system will be implemented to ensure required action is taken by public servants to appropriately mitigate any areas of identified conflict of interest. A phased approach will be used to implement these standards by the target date of 31 December 2010. **Natural Resources Canada's response.** Agreed. The Department has recently launched a Values and Ethics Program Framework built around five pillars: leadership, outreach, policies and procedures, guidance and advice, and oversight. This framework, along with the Department's Corporate Risk Framework, is providing policy guidance, context, and coordination for departmental priorities and action related to conflicts of interest, including the management response to this audit. Consistent with the five pillars, the Department regularly advises on declaration obligations, most recently on 29 June 2010, and will continue to do so on an annual basis. The Department will also be establishing service standards to ensure that such declarations are addressed on a timely basis, with a target date of 31 December 2010 for establishing these service standards.

Recommendation	Response
4.64 Agriculture and Agri-Food Canada, Canadian Heritage, Human Resources and Skills Development Canada, Natural Resources Canada, and Public Works and Government Services Canada should develop an approach to risk assessment that includes identification and prioritization of risks, assessment and mitigation strategies, and residual risk assessment, in the key areas where major conflicts of interest could arise. (4.57–4.63)	**Agriculture and Agri-Food Canada's response.** Agreed. The Department has completed a risk assessment for conflict of interest for 2010. It will use lessons learned from this process, along with any direction and guidance from the Treasury Board of Canada Secretariat on assessing conflict of interest risk, in future assessments. **Canadian Heritage's response.** Agreed. By March 2011, the Department will develop an approach to perform a risk assessment that will identify key areas where major conflicts of interest could arise. The Department will also ensure that the risk assessment results are confirmed on a regular basis, as required. **Human Resources and Skills Development Canada's response.** Agreed. The Department has conducted a preliminary department-wide risk assessment of values and ethics to validate key areas where major conflicts of interests could arise. Building on the results of the preliminary assessment, the Department will conduct further analysis to identify areas of high risk. Risks identified will be prioritized, and appropriate risk mitigation strategies will be developed to address each risk. Key deliverables and timelines for completion of those deliverables will be identified, and indicators to measure success of each risk mitigation strategy will be established. Finally, implementation of these strategies will be monitored and modified when necessary, with planned progress reporting on a bi-annual basis to senior management through corporate committees. A target date of March 2012 has been set for implementing this enhanced risk assessment and related strategies. **Natural Resources Canada's response.** Agreed. As noted in this report, the Department has taken steps to assess risks for conflict of interest. It has launched a corporate risk profile, which is a departmental risk assessment process, to identify, assess, and prioritize corporate-level risks and mitigation strategies. This will include but is not limited to conflict of interest. The corporate risk profile clarifies governance and accountabilities, and fosters employee engagement, training, and risk awareness. The Department will build on this work to more fully and systematically assess potential risk areas. Specifically, through the Values and Ethics Program Framework and its corporate risk profile, the Department has identified its transfer payment (grant and contribution) programs as the highest conflict of interest risk area. The Department has established a

Recommendation	Response
	Centre of Expertise in the Human Resources Branch for Values and Ethics and identified a Values and Ethics Champion at the assistant deputy minister level. The Department's Values and Ethics Champion, managers, and the Centre of Expertise provide advice and guidance to eliminate or reduce conflict of interest. Additionally, the Department added three conflict of interest clauses to its contribution agreements to avoid conflict of interest situations involving employees and recipients. The second conflict of interest priority risk area for the Department is Science and Technology (S&T). An S&T Conflict of Interest Working Group was created and mandated through established terms of reference to focus its efforts in assessing the Department's needs, elaborate relevant working tools, and provide direction on S&T collaboration. Working Group recommendations will be fully implemented by the end of the 2010–11 fiscal year. The third conflict of interest priority area for the Department is contracting and human resources services. By 31 March 2011, the Department will establish guidelines regarding the hiring of former public servants. **Public Works and Government Services Canada's response.** Agreed. The Department has developed a robust approach to risk assessment that includes identification and prioritization of risks; assessments and mitigation strategies; and residual risk assessment. The Department's draft operational risk profile will be finalized by the end of December 2010 and will pay special attention to risks relating to conflict of interest. The Department will use the operational risk profile to refresh its corporate, branch, and regional risk profiles. In addition, the Department will revise the risk categories annex of its Policy on Integrated Risk Management to include conflict of interest risks. It will include these risks in the Department's Risk Management Guide, as well as the training courses for its executives (half-day training session) and for managers and supervisors (one-day session).

Recommendation	Response
4.65 Once they have identified high-risk areas through an appropriate risk assessment process, Agriculture and Agri-Food Canada, Canadian Heritage, Human Resources and Skills Development Canada, Natural Resources Canada, and Public Works and Government Services Canada should require public servants in identified high-risk areas to report regularly, whether or not they have a conflict of interest. **(4.57–4.63)**	**Agriculture and Agri-Food Canada's response.** Agreed. Once the Department has identified its areas at high risk for conflict of interest, it will implement a process where public servants occupying high risk positions in those areas attest regularly that they understand their obligations under the Values and Ethics Code for the Public Service and indicate whether or not they need to submit or update their Confidential Report. Phased implementation will begin in April 2011 in conjunction with the implementation of the new Values and Ethics Code for the Public Service. **Canadian Heritage's response.** Agreed. Once the Department has identified its areas at high risk for conflict of interest, it will implement a new reporting process. Public servants occupying high risk positions will be required to attest regularly that they understand their obligations under the Values and Ethics Code for the Public Service. They will also be required to indicate whether or not they need to submit or update their confidential declaration. The target date for these activities is June 2011. **Human Resources and Skills Development Canada's response.** Agreed. In addition to conducting a robust risk assessment exercise as outlined in the Department's response to the previous recommendation, the Department has initiated the development of an automated confidential report submission process for attestations by its employees. When fully implemented, this process will complement the enhanced risk-assessment exercise currently underway. The attestation will also include a declaration as to whether information submitted in previous confidential report submissions provided to the Department needs to be re-submitted or updated. The target date for launching the pilot phase of the automated confidential report submission system is September 2010. The target date to automate the attestation process for individuals working in identified high risk areas is April 2011. **Natural Resources Canada's response.** Agreed. The Department's Values and Ethics Program Framework includes the implementation in 2010–11 of a process where public servants in high risk positions attest regularly as to whether they are in a situation that could present a conflict of interest. As per the Values and Ethics Code for the Public Service, employees faced with conflict of interest situations are required to submit a confidential report, which is then

Recommendation	Response
	assessed by the Department's Values and Ethics Centre of Expertise. As appropriate, an action plan is developed and implemented to mitigate risks. **Public Works and Government Services Canada's response.** Agreed. Once the Department has identified its areas at high risk for conflict of interest, it will implement a reporting process. Public servants occupying positions in those high risk areas will be required to attest, at an interval appropriate to the risk exposure, that they understand their obligations under the Values and Ethics Code for the Public Service. They will also indicate whether or not they need to submit or update their confidential declaration.
4.72 Canadian Heritage, Human Resources and Skills Development Canada, Natural Resources Canada, and Public Works and Government Services Canada should ensure that their training is based on the conflict of interest risks that staff in specific areas face as they carry out their duties; the training should include case studies and scenarios in these areas. **(4.66–4.71)**	**Canadian Heritage's response.** Agreed. From April 2011, the Department will ensure that conflict of interest training and/or awareness sessions that it provides are based on risk areas identified within the risk assessment and include cases and scenarios related to these areas. **Human Resources and Skills Development Canada's response.** Agreed. The Department recognizes the benefit of developing training that takes into consideration conflict of interest risks that staff in specific areas face as they carry out their duties. The Department further recognizes that improvements can be made to the values and ethics training program it currently has in place, and it will take steps to do so. More specifically, the Department's Office of Values and Ethics, in partnership with Human Resources Services Branch and the Service Canada College, is currently developing training material on conflict of interest to inform employees on avoidance, prevention, and resolution of conflict of interest situations. Further, plans are being developed to ensure that orientation sessions for new employees include realistic case studies, scenarios that new employees would be expected to encounter day to day, and practical strategies for resolution. A draft tool entitled Practical Solutions for Public Servants, designed to assist public servants make ethical decisions, assess post-employment situations, and determine situations that could give rise to conflict of interest, is also being tested. Testing is expected to continue until January 2011, when the Department will determine rollout and implementation.

Recommendation	Response
	Finally, the Department will continue to use the intelligence gained from other activities (for example, Special Investigations Unit outcomes) to ensure its training continues to focus on risk areas specific to its mandate. **Natural Resources Canada's response.** Agreed. The Department's Values and Ethics Program Framework includes conflict of interest employee training. The Department has achieved increasing levels of values and ethics awareness and understanding among managers and employees across the Department. For example, it holds employee engagement sessions, including case studies that address values and ethics as well as conflict of interest situations and appropriate responses. These case studies are and will continue to be updated to ensure they reflect realistic and specific situations related to risks that may be encountered. The Department's key values and ethics activities planned for the 2010–11 fiscal year include the following: • leadership and employee engagement; • outreach and partnering with the Department's communities of practice and with social media technologies, developing a departmental code of conduct; • policies, procedures, and processes to address the Department's needs (for example, establish service standards to address conflict of interest issues); • guidance and advice to ensure awareness of and conformity to the values and ethics code (guidelines for gifts, hospitality, and other benefits); and • oversight (monitoring and evaluation) of the values and ethics program's effectiveness and efficiency (for example, assessing the Department's ethical climate through an internal survey). **Public Works and Government Services Canada's response.** Agreed. The Department is offering training that includes cases and scenarios developed and geared directly toward certain risks identified within a particular area of the Department's operations. For example, the training provided to Parliamentary Precinct Branch employees in May and June 2009 included scenarios for discussion geared to the types of contracting conducted within the branch. Similar training based on identified risks was also delivered within other areas of the

Recommendation	Response
	Department in November 2009 and March 2010. Once the risks in key areas where major conflicts of interest could arise have been identified and prioritized, the Department will review its training program to ensure the program is based on the conflict of interest risks that staff in specific areas could face as they carry out their duties. The Department will also ensure that its updated training program includes relevant cases and scenarios, where appropriate.

Report of the Auditor General of Canada to the House of Commons—Fall 2010

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2010



FALL

Report of the

Auditor General of Canada

to the House of Commons

Chapter 5

Regulating and Supervising Large Banks

Office of the Auditor General of Canada



2010



Report of the

Auditor General of Canada

to the House of Commons

FALL

Chapter 5

Regulating and Supervising Large Banks

Office of the Auditor General of Canada

The Fall 2010 Report of the Auditor General of Canada comprises Matters of Special Importance, Main Points—Chapters 1 to 9, Appendices, and nine chapters. The main table of contents for the Report is found at the end of this publication.

The Report is available on our website at www.oag-bvg.gc.ca.

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Chapter

5

Regulating and Supervising Large Banks

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Regulating and Supervising Large Banks

Main Points

What we examined

In Canada, banks are regulated and supervised by a number of federal organizations responsible for contributing to the stability and efficiency of the financial system. The Department of Finance Canada provides policy advice on the legislation that governs banks and their regulation. The Office of the Superintendent of Financial Institutions Canada supervises banks by assessing their financial condition and verifying their compliance with the laws and regulations that govern them. The Canada Deposit Insurance Corporation provides deposit insurance and has some responsibility over managing risks posed by banks as well as in the monitoring and resolution of failing banks. The Bank of Canada has a role in providing lender of last resort facilities as well as in overseeing clearing and settlement systems.

We examined how the Department of Finance Canada and the Office of the Superintendent of Financial Institutions Canada have regulated and supervised the six largest banks in Canada, which are considered the most important to the Canadian financial system. We also examined how the Department of Finance Canada, the Office of the Superintendent of Financial Institutions Canada, and the Canada Deposit Insurance Corporation shared information for decision making. In addition, we examined how the federal organizations request information from banks.

Audit work for this chapter was substantially completed on 31 March 2010.

Why it's important

Instability in Canada's financial system can cause the public to lose confidence in banks and fear for their savings. It can also have significant fiscal consequences if the government has to step in and provide financial assistance to a bank that is in danger of failing. Banks play key functions in just about every economic exchange that takes place in the economy and are key sources of financing. Therefore, a sound and stable banking system is essential for Canada's economic well-being.

Compared with many other countries, Canadian banks fared well during the recent global financial crisis. Experts have attributed this in part to Canada's approach to regulating and supervising its banks. However, the recent crisis also caused the global financial environment to change at an ever-increasing pace, with international agreements and commitments producing a more complex regulatory framework. In addition, the financial industry continues to develop more diverse and complex financial models and products, which have higher risks. The stability of the banking system could be impacted if Canada's regulatory framework and supervisory approach do not keep pace with these developments.

What we found

- The Department of Finance Canada, the Office of the Superintendent of Financial Institutions Canada, and the Canada Deposit Insurance Corporation regularly share relevant information on regulating and supervising banks. This ongoing exchange of information contributed to Canada's relative success in responding to the recent global financial turmoil as the federal organizations had relevant and up-to-date information for decision making. The Office of the Superintendent of Financial Institutions Canada also interacted appropriately with foreign supervisors and regulators by exchanging information on cross-border issues. These exchanges help Canada stay abreast of emerging issues.

- The federal regulatory framework for banks is kept up to date to reflect emerging domestic and international developments. The legislation governing Canada's banks, the *Bank Act*, is revised every five years following broad consultation. However, there is no process to perform periodic reviews of the effectiveness of the significant parts of the regulatory and legislative framework to determine whether the existing rules and policies support a stable and efficient financial system. Without this type of effectiveness review, it is difficult for the government to determine whether successive regulatory changes are working or have had negative unintended consequences.

- The Office of the Superintendent of Financial Institutions Canada adequately supervises Canada's six largest banks and monitors emerging risks. However, the growing volume and complexity of its work is increasing the demands on its human resources. This challenge, combined with pressures on training and compensation, could affect the Office's ability to attract and retain qualified staff to maintain its capacity and competency to carry out its supervisory mandate.

- Together the Department of Finance Canada, the Office of the Superintendent of Financial Institutions Canada, and the Canada Deposit Insurance Corporation are increasingly asking banks for more information, but they are not periodically assessing whether they need all of this information to fulfill their regulatory and supervisory responsibilities. It is challenging for these entities to precisely determine the amount and type of information required. Although efforts are under way to improve the collection of information, progress on assessing the adequacy of information requested from banks has been limited.

The entities have responded. The entities agree with all of our recommendations. Their detailed responses follow the recommendations throughout the chapter.

Introduction

The importance of regulating and supervising banks

5.1 The fundamental roles of Canada's six largest banks are to make and settle payments for almost all transactions in our economy (clearing and settlement activities), to finance their lending activities through active participation in securities and other capital markets (market activities), and to act as an agent between lenders and borrowers (intermediation activities). This intermediation role is probably the most important since it brings together parties with funds to lend with parties that need to borrow funds. The way banks borrow funds, combined with the risks involved in their lending activities, could, in some circumstances, threaten their solvency. Since large banks have key economic functions and are valuable to society, they need to be regulated and supervised. The six largest banks in Canada are federally regulated. These banks hold over 90 percent of total bank assets (Exhibit 5.1).

Exhibit 5.1 Canada's six largest banks hold over 90 percent of total bank assets

Federally regulated banks	Assets (28 February 2010) ($ billions)
Domestic	
Royal Bank of Canada	651
Toronto-Dominion Bank	568
Bank of Nova Scotia	507
Bank of Montreal	393
Canadian Imperial Bank of Commerce	335
National Bank of Canada	142
Other domestic banks	**58**
Total domestic	**2,654**
Total foreign bank subsidiaries and branches	**212**
Total	**2,866**

Source: Office of the Superintendent of Financial Institutions Canada

5.2 Regulatory activities, including policy advice, establish the legal framework and rules within which banks operate. Supervision involves monitoring the solvency of individual banks by focusing on elements

such as governance, capital adequacy, risk controls, proper accounting of assets and liabilities, and liquidity. Supervision also includes verifying and enforcing the banks' compliance with the rules established by regulation. Regulation and supervision are concerned with the overall stability of the financial system and its efficiency. An effective regulatory framework, which includes regulation and legislation, and a supervisory approach applied by the responsible federal organizations are key components in promoting the solvency of banks and the stability of the financial system. In turn, these elements promote investment and economic growth, which benefit Canadians.

The Government of Canada's role in regulating and supervising banks

5.3 Under the Constitution of Canada, the Government of Canada has sole jurisdiction for regulating and supervising banks. Key federal legislation governs banks and the federal organizations that regulate and supervise them (Exhibit 5.2). Provincial governments regulate and impose rules on credit unions, caisses populaires, securities dealers, and mutual funds.

Exhibit 5.2 Key federal banking legislation governs banks and federal regulatory organizations

***Office of the Superintendent of Financial Institutions Act*, 1985:** Established the Office of the Superintendent of Financial Institutions Canada as the office responsible for regulating and supervising banks. The Act also established the Financial Institutions Supervisory Committee.

***Canada Deposit Insurance Corporation Act*, 1967:** Established the Canada Deposit Insurance Corporation to protect depositors and promote stability of the Canadian financial system.

***Bank of Canada Act*, 1934:** Established the Bank of Canada to regulate credit and currency in the best interests of the economy.

***Bank Act*, 1871:** The main federal statute for regulating and incorporating banks.

5.4 Several federal organizations are responsible for overseeing the banks' activities and for contributing to the stability and efficiency of the financial system. In its regulatory role, the Department of Finance Canada provides policy advice on legislation that governs banks, is responsible for part of the regulatory framework, and oversees the legislative revision process performed every five years. It also establishes, on behalf of the Minister of Finance, the responsibilities and powers of the federal organizations that regulate and supervise banks, such as the Office of the Superintendent of Financial Institutions Canada (OSFI). OSFI regulates and supervises banks to reduce the risk that they will fail. The Superintendent has extensive powers to monitor and advise on banking activities, and to administer

legislation and regulations under the *Office of the Superintendent of Financial Institutions Act* and other federal laws, such as the *Bank Act*. The Superintendent reports to the Minister of Finance and retains sole responsibility for the decisions and actions related to supervision. The Canada Deposit Insurance Corporation (CDIC) insures the deposits in its member banks and has some responsibilities for resolving bank failures in a manner that protects depositors and contributes to the stability of the financial system. The Bank of Canada is primarily responsible for implementing monetary policy, which is an important element in the stability of the financial system. In its role as lender of last resort, the Bank of Canada has the authority to provide liquidity to banks and markets to stabilize the financial sector. The Bank of Canada is also responsible for overseeing clearing and settlement systems.

5.5 The Minister of Finance has delegated spending authority to the Superintendent of Financial Institutions. OSFI establishes its budget for regulating and supervising banking activities and recovers the costs through assessments and fees levied on the banks it supervises.

5.6 In its 2005 Budget, the government announced that it would clarify the roles and responsibilities of OSFI and CDIC and eliminate unnecessary overlap and duplication. These changes reduced the administrative burden on the banks.

Focus of the audit

5.7 This audit examined the Government of Canada's regulatory framework and supervisory approach and related activities between 1 November 2007 and 31 March 2010. The report focuses on **prudential regulation**, which the Department of Finance Canada and OSFI develop to address institutional risk-taking, including ensuring that there are adequate risk controls and capital in place.

Prudential regulation—A set of rules and principles enforced by a government agency that focuses on the safety and soundness of banks, including the safety of depositor's funds.

5.8 We looked at how information was shared among the Department of Finance Canada, OSFI, and CDIC, and how these federal organizations share knowledge and information with foreign regulators and supervisors. We also looked at how these federal organizations request information and data from banks.

5.9 We conducted our audit to determine whether the Department of Finance Canada and OSFI have appropriate processes to regulate and supervise Canada's six largest banks. While CDIC has no legislated regulatory or supervisory responsibilities, it manages risks

posed by member banks and plays a role in finding and implementing solutions for failing banks.

5.10 Our audit examined if and how the regulatory framework is updated and reviewed in light of emerging developments, as well as whether the supervisory approach is reviewed and applied as intended. The audit focused on Canada's six largest banks because these large and complex financial institutions could pose a significant risk to the stability of the Canadian financial system, and the economy, if they fail. These banks are the Royal Bank of Canada, the Toronto-Dominion Bank, the Bank of Nova Scotia, the Bank of Montreal, the Canadian Imperial Bank of Commerce, and the National Bank of Canada.

5.11 More details about the audit objectives, scope, approach, and criteria are in **About the Audit** at the end of this chapter.

Observations and Recommendations

Information sharing

5.12 The Department of Finance Canada, the Office of the Superintendant of Financial Institutions Canada (OSFI), the Canada Deposit Insurance Corporation (CDIC), and the Bank of Canada need to share relevant and timely information to anticipate, assess, monitor, and respond to financial issues and developments that may have consequences for Canada's financial stability. Timely information sharing is necessary to maintain financial stability during financial sector crises. Without information sharing, the organizations that regulate and supervise the banking sector may not be able to properly exercise their roles during crises. For example, the lack of information sharing between regulatory and supervisory authorities was a factor that contributed to the delay in addressing the financial crisis in the United Kingdom, according to the Financial Services Authority of the United Kingdom.

5.13 Although each federal organization in the Canadian regulatory and supervisory system has a distinct mandate, regulators acknowledge that the overall design and function of the system is best served by close coordination and cooperation. The Department of Finance Canada, OSFI, CDIC, and the Bank of Canada share information on regulating and supervising Canada's six largest banks through two primary committees: the Financial Institutions Supervisory Committee (FISC) and the Senior Advisory Committee (SAC). The same federal entities are members of CDIC's Board of Directors and could share information on issues related to large banks as they emerge.

5.14 We examined whether the Department of Finance Canada, OSFI, and CDIC share knowledge and information on regulating and supervising Canada's six largest banks. We looked at documentation from FISC and SAC meetings that took place between 1 November 2007 and 1 November 2009, including agendas, meeting minutes, and documents distributed at the meetings. We also interviewed officials from the Department of Finance Canada, OSFI, CDIC, and the Bank of Canada.

Federal organizations share relevant and timely information for decision making

5.15 We found that during the recent financial turmoil, the federal organizations responsible for regulating and supervising banks met frequently to discuss and address financial stability issues, specific issues affecting banks, international and domestic regulatory developments, and the economy and its impact on the financial system.

5.16 FISC is the main forum through which the Department of Finance Canada, OSFI, CDIC, and the Bank of Canada share and discuss information on banks and coordinate intervention with respect to troubled banks. FISC is chaired by the Superintendent of Financial Institutions and meets quarterly. However, during the recent financial turmoil, it met more frequently to address issues as they arose. We found that, through FISC, the Department of Finance Canada, OSFI, and CDIC shared relevant information to guide decision making.

5.17 SAC is a forum for exchanging information and discussing financial system policy issues, such as proposals for legislative changes, the financial stability framework, and the regulatory framework and supervisory approach. The committee's membership is the same as FISC; however, it is chaired by the Deputy Minister of Finance. SAC usually meets three or four times a year. We found that the discussions of issues that take place at these meetings influence policy changes.

5.18 We found that FISC and SAC facilitate the exchange of information among federal organizations. In addition, the participation of the Department of Finance Canada, OSFI, CDIC, and the Bank of Canada in FISC and SAC has strengthened informal relationships among these federal organizations. We also found that these relationships played an important role throughout the recent financial turmoil, when officials from these federal organizations maintained regular contact with each other outside of FISC and SAC meetings.

The Office of the Superintendent of Financial Institutions Canada receives relevant information from foreign regulators and supervisors

5.19 Supervising banks with international operations requires that regulators, supervisors, deposit insurers, and central banks cooperate and exchange information to strengthen supervision and promote financial stability. We examined whether OSFI interacts appropriately with regulators and supervisors from other countries on cross-border issues. We looked at correspondence, meeting minutes, and memoranda of understanding between the federal organizations and their foreign counterparts regarding the international operations of Canada's six largest banks. We also interviewed OSFI officials.

5.20 We found that OSFI exchanges information with its foreign counterparts on cross-border issues through its participation in international committees and working groups of supervisors that aim to enhance the supervision of banks with international operations. This participation also helps OSFI build relationships, gain influence at the international level, and keep informed of upcoming changes to international policies and guidelines. OSFI officials told us that they are satisfied with the information they receive from their foreign counterparts. We also found that OSFI receives relevant information on Canadian banks operating abroad to fulfill its regulatory and supervisory role.

Regulation

Stable financial system—A system that is robust in the face of a wide range of adverse circumstances.

Efficient financial system—A system that produces a wide range of financial products at the least possible cost and is capable of significant innovation.

5.21 The objective of regulating banks is to achieve a **stable and efficient financial system**, which is in the public's interest. Market forces alone are not sufficient to achieve this objective because banks do not bear all of the economic costs of their activities. Three important reasons for regulating banks are to contain systemic risk, to contain moral hazard, and to protect consumers (Exhibit 5.3). Exhibit 5.4 outlines the policy guidance included in the banking regulatory framework.

5.22 We examined whether the Department of Finance Canada and the Office of the Superintendent of Financial Institutions Canada (OSFI) maintain and update the regulatory framework in light of emerging developments, such as the recent financial turmoil, and periodically review its effectiveness. We looked at documents such as emerging international principles, minutes of federal committee meetings, and related documents. We also interviewed officials of the federal organizations and representatives from Canada's six largest banks.

Exhibit 5.3 Governments have three important reasons for regulating banks

Three important reasons for regulating banks are to contain systemic risk, to contain moral hazard, and to protect consumers.

Banks may take excessive risks in their activities. If these risks result in a bank failing, other banks may fail or be threatened with insolvency because of their connections with this bank. This could threaten the broader financial system and the performance of the economy.

The moral hazard motivation arises from attempting to protect depositors from losses. If governments introduce protection systems to compensate depositors for losses resulting from a bank's insolvency, then depositors will have little or no incentive to assess the riskiness of their deposits and investments. Riskier banks will attract deposits on the same conditions as less risky banks. In addition, the belief that governments will intervene if a large bank fails also undermines investor and depositor discipline. To mitigate moral hazard, governments introduce mechanisms such as capital adequacy requirements to limit financial exposure and excessive risk-taking activities.

Governments introduce banking regulations to reduce the level of risk that consumers are exposed to. For example, governments introduce protection systems for depositors to reimburse them for losses arising from the insolvency of a bank.

Exhibit 5.4 The Office of the Superintendent of Financial Institutions Canada issues policy guidance as part of the banking regulatory framework

The banking regulatory framework contains policy guidance issued by the Office of the Superintendent of Financial Institutions Canada (OSFI). This guidance includes the following:

- Guidelines that describe OSFI's expectations with respect to risk management principles, addressing solvency issues (for example, capital adequacy); prudential standards (for example, exposure limits); and accounting standards (for example, transfer of assets). There are 28 guidelines.
- Advisories that clarify OSFI's position regarding certain policy issues or how provisions of legislation, regulations, or guidelines should be interpreted. There are 57 advisories.
- Rulings that describe how OSFI has applied or interpreted provisions of legislation, regulations, or guidance. There are 23 rulings.

While guidance does not have the force of law, it sets out expectations regarding specific risk management principles. Banks are expected to consider the guidance and to take appropriate action. Therefore, banks should voluntarily comply with expectations set out in guidance documents. If a bank's failure to comply with guidance creates concerns about its safety and soundness, the Superintendent of Financial Institutions can use other intervention powers, such as issuing an order to force compliance or an order to increase the level of capital.

Source: Department of Finance Canada and Office of the Superintendent of Financial Institutions

Federal organizations actively monitor emerging issues

5.23 Following the recent financial turmoil, a large number of international committees and initiatives were established to review and improve the global financial system's regulatory framework. International groups, including the Financial Stability Board, the Basel Committee on Banking Supervision, the Senior Supervisors Group, and the G-20 Finance Ministers, are examining the causes of the financial crisis and what could be done to address identified problems. There have been hundreds of proposals for changes to the financial system, all with the objective of enhancing the resilience of the global financial system and building a more consistent regulatory framework and supervisory approach worldwide.

5.24 Regulations and best practices are now rapidly evolving, and, because of the fast pace of innovation in the financial services sector, regulatory frameworks are being revised. In addition to international developments, emerging domestic issues need to be monitored. We examined how the Department of Finance Canada and OSFI monitor emerging domestic and international developments to ensure that Canada's regulatory framework is kept up-to-date.

5.25 We found that the Department of Finance Canada tracks emerging domestic and international issues and that OSFI monitors and analyzes economic and market data pertaining to domestic and international developments. OSFI recently established a research group to analyze emerging economic issues and market behaviour. OSFI also relies on its Emerging Risk Committee (ERC), which identifies emerging issues and external risks affecting the financial services industry. At its monthly meetings, the ERC discusses topics such as domestic and global market updates, economic conditions, real estate risks, and credit risks, along with possible supervisory responses.

5.26 We found that federal organizations track emerging issues through their participation in committees and working groups at the federal and international levels. These committees and working groups provide important information on emerging trends and policy development.

5.27 The two principal domestic forums for monitoring emerging domestic and international risks are the Financial Institutions Supervisory Committee (FISC) and the Senior Advisory Committee (SAC). We found that emerging issues, such as liquidity risk management, accounting rules, and cross-border issues, were discussed at FISC meetings. Issues related to the legislative and regulatory

framework, such as boundaries of regulation, consumer protection issues, and stability issues, among others, were presented at SAC meetings.

5.28 International issues are monitored through Canada's participation in global forums, including the G-7, G-20, and the Financial Stability Board. In addition to these forums, the Department of Finance Canada and OSFI participate in over 50 international committees and working groups.

Federal organizations maintain and update Canada's regulatory framework

5.29 Keeping the regulatory framework up-to-date is particularly important in the context of market innovation and global financial turmoil. An outdated regulatory framework poses a number of risks and may lead to negative unintended consequences. For example, banks may face a costly compliance regime in pursuit of a regulatory objective that is no longer valid. As well, banks may not be able to adapt to changes and innovations in financial markets if the regulatory framework is not sufficiently flexible. Ultimately, without an effective regulatory framework, the safety and soundness of banks could be jeopardized. We reviewed the processes in place at the Department of Finance Canada and OSFI to maintain and update the legislative and regulatory framework.

5.30 Canada has been regularly updating its financial sector legislation and regulations for more than 135 years. The legislation governing Canada's banks, the *Bank Act*, is revised every five years. Revisions can include regulatory issues raised by stakeholders or FISC partners, or identified in analysis. Some legislative reviews have been used in the past to fine-tune the framework, while others introduced significant policy shifts reflecting fundamental changes in the financial sector (such as in 2001, following the MacKay Task Force). The next revision is scheduled for April 2012. The legislated five-year review provision helps keep the regulatory framework current and provides banks with the flexibility they need to react to changing times. Bills to implement budget measures and other legislation have been used recently to amend the *Bank Act* in the period between the five-year reviews.

5.31 We found that OSFI is maintaining the relevance of its guidelines. More detailed and prescriptive guidelines are subject to regular updates, and OSFI uses a flexible rule-making approach to address emerging risks and opportunities. It has substantial discretion to put forward principles in the form of guidance. During the financial turmoil, OSFI used its power to issue and interpret guidance to restrict

undesirable activities and to permit flexibility. For example, in 2008, OSFI revised the limit on voting equity shares to provide banks with additional financial flexibility, and it released a revised intervention process for dealing with weakening or failing banks.

Canada contributes and adheres to international standards when appropriate

5.32 One challenge for national regulators worldwide is to influence the international agenda for the financial sector, as well as to adapt proposed changes and implement them. Since the financial turmoil, new regulatory principles and standards have been and continue to be developed internationally. We examined the role that Canada's federal organizations have had in developing new international standards and principles, and the review they performed before adopting them.

5.33 Canada's participation in international meetings allows Canada to monitor and shape international developments. We found that federal officials from the Department of Finance Canada and OSFI are involved in developing international standards and that they exercise some influence. Canada co-chaired the G-20 Working Group on Enhancing Sound Regulations and Strengthening Transparency. Senior officials from the Department of Finance Canada, OSFI, and the Bank of Canada are contributing members of the Financial Stability Board (FSB) and related working committees. The Department of Finance Canada and OSFI participated in developing FSB principles on sound compensation practices. A senior Government of Canada representative chairs the FSB Standing Committee on Standards Implementation, and Canada has two members on the steering committee that provides direction to the FSB.

5.34 We found that the Department of Finance Canada and OSFI are committed to the proposed reforms to the extent they are relevant to Canada's financial system. For example, Canada was among the first countries to adopt the Basel II Capital Accord in 2007, which recommends new bank capital requirements in light of the bank's management of risk. The Department of Finance Canada also implemented principles for cross-border cooperation on crisis management. At OSFI, guidance on adequate levels of capital will be revised to align with the new Basel II Capital Accord guidance. As well, OFSI will update guidance on liquidity and leverage once the international standards are established.

5.35 A well-developed regulatory framework should show that international standards are monitored and being adhered to when appropriate. Canada undergoes international compliance assessments,

and, in 2008, the International Monetary Fund found that OSFI complied with the Basel Core Principles for Effective Banking Supervision. As well, Canada has volunteered to be reviewed by its FSB peers in 2011 to assess progress regarding the implementation of international standards.

5.36 We found that the Department of Finance Canada and OSFI are reviewing the benefits of particular international standards to assess if and how Canada could adopt them. While the federal organizations are aware that international organizations influence the domestic regulatory agenda, they also recognize that their primary objective is to adopt regulations that are appropriate for Canada and that adjustments are required to take into account Canadian circumstances. New international standards and proposals are being assessed within the Canadian context. For example, Canada took a strong position against the imposition of a tax on banks that some members of the G-20 were considering. Also, the approach Canada took to implement the FSB principles on compensation was principles-based, in contrast to some countries that rely on a more prescriptive rules-based approach.

Significant parts of the regulatory framework are not subject to periodic reviews of their effectiveness

5.37 A well-designed regulatory framework needs to be regularly reviewed to determine whether policy objectives are being achieved and whether unintended consequences might require the reconsideration of part of the framework. According to the Organisation for Economic Co-operation and Development, the efficiency and effectiveness of financial regulation should be reviewed and evaluated regularly to reassess previously identified problems and needs in the policy framework, identify new problems, adjust policy objectives, assess the effectiveness and efficiency of policy instruments and their readiness for implementation, and assess the processes for making and implementing regulations.

5.38 Considering the large number of legislative and regulatory changes that have been introduced and those that will be introduced in the future, it is particularly important to ensure that the regulatory framework is effective and working as intended, while minimizing negative consequences, and to measure the impact of these cumulative changes on the regulatory framework. We examined how the Department of Finance Canada and OSFI review the effectiveness of the regulatory framework.

5.39 The Cabinet Directive on Streamlining Regulation, introduced in 2007, requires federal departments and agencies to ensure that regulation meets their initial policy objectives and to renew regulatory frameworks on an ongoing basis. We found that the Department of Finance Canada performed some reviews of the effectiveness of bank regulations. The Department's analysis included research on issues such as market failures, the appropriateness of restrictions, and risk to banks. We found, for example, that the Department of Finance Canada, in collaboration with CDIC, reviewed the options available for dealing with a large bank in case of failure. They assessed the shortcomings, costs, and benefits of the resolution tools; made international comparisons; and considered policy issues related to implementing resolution tools. Following this review, the government introduced amendments to the *Canada Deposit Insurance Corporation Act* to allow for an additional failure resolution tool. Also, the Department reviewed the rules governing credit rating agencies and leasing for their effectiveness.

5.40 However, we found that there is no systematic process at the Department of Finance Canada to plan and periodically perform reviews of the regulatory framework, or consistency in the analysis and reporting of the reviews. The Department performs reviews of regulatory issues on an ad hoc basis. Emerging domestic issues or new international standards usually trigger specific reviews. In addition, the Department has not yet implemented the Cabinet Directive on Streamlining Regulation.

5.41 We found that OSFI performed a review of the effectiveness of outsourcing rules. We also found that, in 2005, OSFI reviewed corporate governance rules. OSFI officials indicated that they will review two other guidelines in the 2010–11 fiscal year. OSFI is presently implementing the Cabinet Directive on Streamlining Regulation and will integrate the requirement to perform reviews into its rule-making process.

5.42 While the Senior Advisory Committee, chaired by the Department of Finance Canada, discusses broad policy directions related to financial sector issues, it does not have terms of reference. As well, there is no defined process for identifying financial sector policy issues that need to be reviewed for their effectiveness and the timing of these reviews, or for discussing the findings. The result of these reviews could support proposals for legislative changes or provide assurance to policy makers that the objectives of the regulatory

framework are being met as intended and that they support the achievement of a stable and efficient financial system while minimizing unintended consequences.

5.43 Recommendation. As chair of the Senior Advisory Committee, the Department of Finance Canada should establish the committee's terms of reference, in collaboration with its members. These terms of reference should require the development of plans to perform effectiveness reviews of the regulatory and legislative framework to ensure that significant parts of the regulatory framework are periodically assessed.

The Department's response. Agreed. The Department will consider the recommendation to establish terms of reference for the Senior Advisory Committee (SAC), in consultation with the Bank of Canada, the Office of the Superintendent of Financial Institutions Canada, the Canada Deposit Insurance Corporation, and the Financial Consumer Agency of Canada, including giving SAC a mandate to regularly review the effectiveness of the regulatory and legislative framework.

Supervision

5.44 The objectives of supervising banks are to assess their safety and soundness and to intervene when necessary to protect depositors. The Office of the Superintendent of Financial Institutions Canada (OSFI) uses a supervisory approach that focuses on risks and can be easily adapted to changes in the financial system (Exhibit 5.5). Because this approach is based on principles and not on a specific detailed set of rules, the banks' activities must comply with the regulatory objectives.

5.45 We examined whether OSFI periodically reviews the relevance and application of its supervisory approach. We also examined whether it updates the supervisory approach in light of emerging domestic and international developments, as well as international principles and commitments. We examined whether OSFI appropriately applied the supervisory approach when assessing the safety and soundness of banks and the financial system. We looked at documents such as OSFI's Supervisory Framework and the associated methodology for carrying out the supervisory work in banks. We also examined the documentation that supported OSFI's supervisory review of Canada's six largest banks for the banking year starting 1 November 2008. In addition, we obtained input from OSFI officials and senior executives of Canada's six largest banks.

Exhibit 5.5 The Office of the Superintendent of Financial Institutions Canada relies on risk assessment to supervise banks

The Office of the Superintendent of Financial Institutions Canada (OSFI) supervises Canadian banks on a consolidated basis, including their domestic and international operations, to assess their safety and soundness. The level and frequency of supervisory scrutiny depends on the results of the risk assessment of the bank's significant activities. OSFI's supervision has four phases: planning, examination, reporting, and follow up.

Planning the supervisory work involves understanding the financial environment; identifying the bank's significant activities; and outlining the supervisory approach and supporting rationale for the nature, focus, and timing of supervisory work required to evaluate a bank's risk profile. OSFI's supervisory staff must use sound judgment to determine the significance and materiality of activities in which a bank engages.

Examination focuses on evaluating risks through on-site reviews and ongoing monitoring, including assessing compliance with laws and regulations. On-site reviews are a critical part of the supervisory process since they enhance OSFI's understanding of the bank and its risk profile. OSFI also reviews the bank's risk management practices. OSFI senior supervisors discuss the examination results to determine whether appropriate judgment was exercised and consistently applied across banks.

Reporting includes verbal and written communication of findings, ratings, and recommendations to OSFI's management, as well as the bank's board management.

Follow up on the recommendations addressed to banks is important for assessing progress.

Source: Office of the Superintendent of Financial Institutions Canada

The Office of the Superintendent of Financial Institutions Canada is updating its Supervisory Framework

5.46 Officials from the federal organizations we audited and senior executives of Canada's six largest banks told us that the Supervisory Framework is understood by the banks and has proven to be effective. It is also flexible, which means that it can be adapted quickly to respond to new policies, regulatory issues, and emerging financial market developments. OSFI is currently reviewing and updating its 1999 Supervisory Framework. The review is expected to be finalized by the end of 2010. Such a review allows OSFI to incorporate new approaches and standards to address significant changes in the external environment. Some of these changes, such as implementing the Basel II Capital Accord, are internationally driven. We found that OSFI has implemented the changes required by international agreements in its supervisory approach.

The Office of the Superintendent of Financial Institutions Canada supervises large banks adequately

5.47 Since OSFI's principles-based supervisory approach relies heavily on the judgment of its supervisory staff, it is important for OSFI to have knowledgeable staff who follow the supervisory methodology and document their results. This encourages a consistent application of the supervisory approach across banks. We examined the phases of supervision—planning, examination, reporting, and follow up. We found that OSFI followed its supervisory approach in assessing the activities of the large banks for the year we looked at, even though we found some areas for improvement in our detailed examination.

5.48 We found that planning work was carried out in all cases. However, in four percent of cases, OSFI did not evaluate all activities that were scheduled for assessment. In addition, we could not find documented evidence that planning decisions were appropriately reviewed in all cases. For example, lower-risk activities such as the use of credit cards and personal banking were not assessed as planned. Not carrying out these assessments could result in not identifying risks that may increase over time. As well, because priority setting is partially judgment-based, it is important for senior supervisory staff to review the activities that are planned for assessment.

5.49 We found that the examination work was performed according to OSFI's methodology. However, our detailed examination found documentation lacking. Specifically, 4 percent of the risk assessments for a significant activity were out of date, and 17 percent could not be provided by OSFI. Recent internal audits by OSFI had identified issues with the documentation of analysis. We also found that there was no documented evidence that all assessment summaries were reviewed by senior supervisors, which could increase the likelihood that risks are understated or overstated and not consistently analyzed across banks.

5.50 We found that the results of examinations are reported appropriately and in a timely manner to the banks' senior management. This means that banks are aware of OSFI's views of their risk assessment and mitigation activities and can take corrective actions, if necessary. We also found that OSFI followed up on its recommendations in a timely manner.

The Office of the Superintendent of Financial Institutions Canada is well-regarded by the banks it supervises

5.51 Through questionnaires and interviews with senior bank executives from Canada's six largest banks, we found that they considered OSFI's supervisory staff to be knowledgeable and professional. All of these executives regarded OSFI as a strong supervisor and said that the relationship between the banks and OSFI was working well. Frequent and open dialogue between OSFI and the banks and OSFI's willingness to consider the banks' views were also credited as promoting a positive working relationship.

5.52 OSFI's supervisory approach is also well-regarded by the international community. Officials from federal organizations and bank executives indicated that this regard allows OSFI to effectively represent the interests of Canadian banks and influence the development of international commitments.

Increased regulatory requirements have created human resource challenges

5.53 OSFI's success as a supervisor depends on having employees with highly specialized knowledge, skills, and experience to supervise banks, identify significant issues, and perform accurate assessments of how banks manage risks. We found that OSFI has a human resource strategy and understands its importance for fulfilling its mandate. However, OSFI faces challenges in the current environment.

5.54 Demands on OSFI's supervisory staff have increased. In recent years, the demands have risen in large part due to an increase in the number and complexity of financial activities and financial products, the implementation of international standards, and an increased requirement to formalize and document OSFI's processes and analysis. In December 2007, OSFI noted that supervisory resources were under considerable pressure and that it would be seeking additional resources to carry out its key activities. The issues raised then are still relevant today. While staffing levels have increased since that time, staffing gaps remain. As of 31 March 2010, 10 percent of the positions on the large bank supervisory teams and 12 percent of the positions on the specialist groups supporting them were vacant. Half of these positions have been vacant for one year. According to OSFI, this illustrates that resources are stretched and that there is little flexibility to address unexpected events or attend to managerial responsibilities such as staffing and training.

5.55 Currently, OSFI considers its supervisory staffing levels adequate to carry out its supervisory responsibilities. However, we found that a number of supervisory staff had to be redeployed to assist with the

recent industry-wide executive compensation review. In addition, increased documentation requirements have resulted in less time available for detecting and analyzing risks.

5.56 Senior executives of the six largest banks indicated that OSFI's supervisory staff are currently stretched and that, if competition for hiring in the banking industry increases, OSFI may not be in a position to attract or even retain some of its qualified staff. We also found that OSFI staff are challenged by the increased volume and complexity of the work. This could lead to risk areas not being assessed appropriately and quickly, resulting in increased risk. Bank executives told us that OSFI's current staff are having difficulty reviewing the banks' capital models because of the models' complexity; they have increasingly relied on consultants to perform reviews of the information technology system and financial model.

5.57 We found that while OSFI is aware that training is important for attracting, developing, and retaining staff, work pressures, unexpected market developments, and budget constraints have resulted in less external training than is required to keep up-to-date in specialized areas. As a result, OSFI supervisory staff may not be exposed to the latest financial market innovations, which could result in risks being underestimated or overlooked. In addition, less specialized training could make it more difficult to attract and retain staff who consider training an integral part of their career development.

5.58 The federal government, through its 2010 Budget, signalled the need to exercise financial restraint. As a result, OSFI is looking to bring its budgets for fiscal years 2010–11 to 2012–13 in line with the government's expectations, even though spending for the regulation and supervision of banks is not funded by the federal government, but recovered through assessments and fees levied on the banks themselves. OSFI has been aware for awhile that its supervisory staff compensation is not competitive with the banks and had planned to make adjustments to the way it remunerates its supervisory staff; however, it did not initiate this given the federal government's current financial restraint. Bank officials indicated that the compensation gap is likely to increase further due to anticipated increases in bank staff compensation. This will likely increase OSFI's difficulties in attracting and retaining high-quality staff.

5.59 Recommendation. The Office of the Superintendent of Financial Institutions Canada should update its human resource planning strategy, including specialized training and compensation practices, to ensure that it is in a better position to attract and retain qualified staff.

The Office's response. Agreed. The Office is aware that its compensation structure for all positions at the executive level (including, but not exclusively, supervisory staff) is behind the targeted level and was preparing to revise the structure when the *Expenditure Restraint Act* was introduced. The Office has also changed its approach to market data collection to ensure a more quantifiable means of tracking market movement.

The Office is also aware of the need to ensure that employees are prepared for emerging risks via opportunistic and timely training.

The Office has a comprehensive human resource (HR) planning process that outlines specific strategies to address major opportunities and challenges. Its HR Strategy is revised annually to ensure timely recruitment and retention of the right people with the necessary skills. The HR Plan and Strategy outline the need for the compensation structure to remain competitive and to provide proactive and timely learning opportunities.

We are reviewing options to bring our salary structure more in line with our historical compensation philosophy. This revised structure will be brought forward for approval in the fall of 2010, with implementation after the expiry of the *Expenditure Restraint Act* in April 2011. For training practices, we will ensure that we focus on specialized areas of risk, while continuing to provide opportunistic training for employees.

Data and information requests

5.60 Regulators and supervisors need to collect, review, and analyze reports and statistics from banks to perform their duties. Without appropriate information, supervisors are not able to adequately assess the different risks and this could have important consequences for the financial system. There are two types of data and information requests: **regularly reported** and **ad hoc**. We examined whether the Department of Finance Canada, the Office of the Superintendent of Financial Institutions Canada (OSFI), and the Canada Deposit Insurance Corporation (CDIC) request necessary and sufficient information from banks and use this information for regulating and supervising. We reviewed the documentation related to the collection of information and gathered input from OSFI officials and senior bank representatives through a questionnaire and interviews.

Regularly reported request—Financial data that comes from the financial regulatory returns that the banks have to complete periodically. Other information, such as management reports regularly submitted on financial, credit, and market risk, is also considered to be regularly reported information.

Ad hoc request—Information that is collected when up-to-date information is needed or when the financial data is not found in the financial regulatory returns.

Efforts to improve the collection of information are still ongoing

5.61 In 1998, the Bank of Canada, in partnership with OSFI and CDIC, developed a system to collect, validate, manage, and maintain financial regulatory returns from banks. This system, known as the

Tri-Agency Database System, is jointly owned and operated by the three federal organizations.

5.62 The Department of Finance Canada, OSFI, CDIC, and the Bank of Canada are members of the Financial Information Committee (FIC), whose mandate includes assessing and coordinating the ongoing regularly reported financial information requirements of all member federal organizations in a cost-effective manner. The Department of Finance Canada, OSFI, and CDIC request information from banks and use it for regulating and supervising.

5.63 In 2003, the banks requested a review of regularly reported data to assess whether the data submitted by banks to FIC members continued to be relevant, and to create efficiencies in how the data is collected and reported. This led to the Data Rationalization Project, which so far has resulted in the deletion of a small number of data points compared with the total collected. Changes to data requirements are currently under way and additional changes will be made pending the finalization of new Basel rules.

5.64 In addition, an annual housekeeping exercise provides each FIC member with an opportunity to identify data that should be deleted or added to the financial regulatory returns, while taking into account regulatory and accounting changes. Based on this input, FIC discusses possible deletions and additions and informs the banks. Over the last two years, and due to new rules that require data changes, the annual housekeeping exercise has resulted in more data points being added than were deleted. The annual housekeeping exercise does not review ad hoc information requests.

5.65 We found that there is increased collaboration between the FIC members and the banks, and that the banks better understand what information is requested, why it is requested, and how federal organizations use it. We also found that the Data Rationalization Project, the annual housekeeping exercise, and FIC discussions have further reduced duplicate data requests, even though the number of data points has increased due to international pressure for FIC members to collect new data.

5.66 For each large bank, the total number of fields on OSFI regulatory returns increased from 24,000 to up to potentially 10 million following the Basel II Accord and to allow for future data gathering requirements as financial models evolve. Banks fill out the fields applicable to their operations. Each large bank now can submit up to half a million data points annually to OSFI as a result of the

increase in the size of the returns. The Tri-Agency Database System (TDS) was not designed to handle the new types of data, such as that required by the Basel II Accord, or the increased volume of data. Federal officials told us that there are plans to replace the TDS. The design of the new TDS should begin in 2011, with development expected to take several years.

Financial Information Committee members could improve coordination of information requests

5.67 The growing number of federal requests for information from banks pose challenges. We found that coordination among FIC members could be improved as there is no registry of the ad hoc information requested from the banks, which could lead to duplication of requests. We also found that the information the banks provided to the federal organizations in response to ad hoc requests is sometimes inconsistent. For example, when ad hoc requests are not well defined, the banks could interpret them in different ways. Also, federal organizations sometimes use readily available information from the banks for analysis even though this information may not be comparable across banks.

5.68 We found that it is difficult for FIC members to precisely determine the appropriate amount and type of information needed to fulfill the supervisory and regulatory needs. For example, some regularly reported data may not be currently used but may be retained for potential future use. Also, FIC members may want more information to assess new risks.

5.69 Future economic circumstances may require data that is different from the information already available. Therefore, ad hoc requests will always be necessary and could sometimes be numerous depending on the circumstances, such as during the recent financial turmoil. Banks recognize the benefits of being regulated and the need to provide data to FIC members. Federal organizations need to minimize the reporting burden on banks while still collecting the information they require to fulfill their mandates. Collecting, compiling, and disseminating data are costly activities for federal organizations and banks, and analyses need to be done before reducing or introducing additional reporting burdens. Banks and FIC members have a common interest in collecting relevant data in a cost-effective manner.

5.70 Recommendation. As chair of the Financial Information Committee, the Office of the Superintendent of Financial Institutions Canada, in collaboration with committee members, should periodically

review regular and ad hoc information requests that it makes to banks to determine whether information collected is relevant, accurate, and sufficient, while carefully assessing the cost-effectiveness of changes to reporting requirements.

The Office's response. Agreed. The Financial Information Committee (FIC) has pursued its mandate through a common framework that challenges changes to regular financial data collection and the associated reporting burden.

Ad hoc data requests are normally time-sensitive, and, unlike regular data, not conducive to FIC oversight. However, we recognize the need for more formal processes within each agency, and these are under development.

By March 2011, the Office will formally implement a Financial Management Information Policy that outlines principles, processes, accountabilities, governance, and oversight for data collection. The treatment of ad hoc data is included in this policy.

During the Annual Housekeeping exercise, starting in May 2011, FIC will formally reconfirm and minute the relevance and usefulness of the regular data being collected. FIC will discuss any data that could be eliminated.

Also, as part of the Annual Housekeeping process, FIC will engage the banking industry, via the Canadian Bankers Association, on the cost/benefits of a periodic data review exercise and improvements to our ad hoc data collection processes.

Conclusion

5.71 According to some international organizations, Canadian banks suffered less than most countries during the recent period of financial turmoil, in part, because its regulatory framework and supervisory approach, including communication among federal organizations, are effective. A recent, international peer review and the financial crisis have shown that the Canadian regulatory framework is robust. The challenge for Canada is to maintain that advantage in a context where new international standards are introduced, where banks are innovating and getting more complex, and where financial markets are rapidly evolving.

5.72 We found that the Department of Finance Canada, the Office of the Superintendent of Financial Institutions Canada (OSFI), the

Canada Deposit Insurance Corporation (CDIC), and the Bank of Canada regularly share relevant information on regulating and supervising banks through formal committees, such as the Financial Institutions Supervisory Committee (FISC) and the Senior Advisory Committee (SAC), and through informal relationships. The ongoing exchange of information helped Canada maintain its financial stability during the recent global economic crisis. We also found that OSFI interacts appropriately with foreign supervisors and regulators by exchanging information on cross-border issues.

5.73 We found that the Department of Finance Canada, OSFI, and CDIC have appropriate processes that are consistent with their mandates, to regulate and supervise large banks.

5.74 We found that legislation, regulations, and guidelines are regularly updated in light of emerging domestic and international developments. At the Department of Finance Canada, we found that some parts of the existing rules or past policy decisions have been assessed for their effectiveness using an ad hoc approach. There is no process for planning periodic reviews of the effectiveness of the regulatory and legislative framework in order to determine whether the existing rules and policies support the achievement of a stable and efficient financial system. We found that OSFI has reviewed the effectiveness of one guideline during the period we examined, and had also conducted another review in 2005. New OSFI guidelines and OSFI-sponsored regulations will now be reviewed for their effectiveness under the Cabinet Directive on Streamlining Regulation.

5.75 We found that OSFI assesses and updates its supervisory approach and monitors and implements emerging domestic and international principles and commitments. We also found that OSFI applies the supervisory approach as intended with respect to the large banks. However, human resource challenges are increasing due to increased workloads, financial restraint, and less time for training.

5.76 Together, the Financial Information Committee members are requesting growing amounts of regular and ad hoc information for regulating and supervising banks. However, managing information remains a challenge and continuous efforts are required to ensure that relevant, accurate, and sufficient information is requested from the banks.

About the Audit

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by The Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

Objectives

The audit examined whether the Department of Finance Canada, the Office of the Superintendent of Financial Institutions Canada (OSFI), and the Canada Deposit Insurance Corporation (CDIC) have appropriate processes that are consistent with their mandates to regulate and supervise large banks. The audit had the following sub-objectives:

- to determine whether the Department of Finance Canada, OSFI, and CDIC, to fulfill their responsibilities, exchanged and considered knowledge, information, and data on the regulation and supervision of large banks among themselves and whether OSFI shared information with international regulators and supervisors;
- to determine whether the Department of Finance Canada and OSFI had appropriate practices in place that are consistent with their mandates and designed to keep the regulatory framework relevant to the fulfillment of their responsibilities; and
- to determine whether OSFI assesses the relevance and appropriateness of the supervisory approach and whether it applies it as intended.

Scope and approach

The audit included the Department of Finance Canada, OSFI, and CDIC. At the Department of Finance Canada, we looked at the Financial Sector Policy Branch. At OSFI, we looked at the Regulation and Supervision sectors. At CDIC, we looked at the Insurance and Risk Assessment area. We also interviewed officials from the Bank of Canada. We did not include the Financial Consumer Agency of Canada because it does not have prudential regulatory responsibilities.

The audit focused on the six largest Canadian banks because these large and complex financial institutions could pose a significant risk to the stability of the Canadian financial system. These banks are the Royal Bank of Canada, the Toronto-Dominion Bank, the Bank of Nova Scotia, the Bank of Montreal, the Canadian Imperial Bank of Commerce, and the National Bank of Canada.

We reviewed various documents, including reports, minutes of meetings, and standards issued by international committees. We also reviewed the literature on the subject and interviewed senior representatives from each of the six large banks. We examined the regulatory activities carried out by OSFI and the Department of Finance Canada from 1 November 2007 to 31 March 2010. We also examined the supervisory work carried out by OSFI from 1 November 2007 to 31 October 2009, with a focus on the most recent full banking year from 1 November 2008 to 31 October 2009. The audit did not challenge the judgment of the supervisory work performed by OSFI. In addition, we examined the practices in place to exchange information between federal organizations and the banks.

Criteria

To determine whether the Department of Finance Canada, the Office of the Superintendent of Financial Institutions Canada (OSFI), and the Canada Deposit Insurance Corporation, to fulfill their responsibilities, exchange and consider knowledge, information, and data on the regulation and supervision of large banks among themselves and whether OSFI shared information with international regulators and supervisors, we used the following criteria:

Criteria	Sources
The Department of Finance Canada, Office of the Superintendent of Financial Institutions (OSFI), and the Canada Deposit Insurance Corporation (CDIC) share knowledge and information on the regulation and supervision of banks.	• *Office of the Superintendent of Financial Institutions Act* (1985), section 18 • Basel Committee on Banking Supervision, Core Principles for Effective Deposit Insurance Systems, June 2009, principle 6 • Government of Canada, Cabinet Directive on Streamlining Regulation, 2007, Coordinating across the Government of Canada, page 7
OSFI interacts appropriately with regulators and supervisors from other countries on cross-border issues.	• Government of Canada, Cabinet Directive on Streamlining Regulation, 2007, International cooperation, page 8 • Basel Committee on Banking Supervision, Core Principles for Effective Banking Supervision, October 2006, principle 25 • Basel II, 2006, paragraphs 780 to 783 • Basel Committee on Banking Supervision, Report and Recommendations of the Cross-border Bank Resolution Group, September 2009, recommendations 4, 5, and 7
The Department of Finance Canada, OSFI, and CDIC request appropriate information from banks and use this information for regulating and supervising.	• *Office of the Superintendent of Financial Institutions Act* (1985), section 22 (2) • *Bank Act* (1991), section 628 (1) • Basel Committee on Banking Supervision, Core Principles for Effective Banking Supervision, October 2006, principle 21

To determine whether the Department of Finance Canada and OSFI have appropriate practices in place that are consistent with their mandates and designed to keep the regulatory framework relevant to the fulfillment of their responsibilities, we used the following criteria:

Criteria	Sources
The Department of Finance Canada and OSFI periodically review the relevance of the existing regulatory and legislative framework.	• Organization for Economic Cooperation and Development, Policy Framework for Effective and Efficient Financial Regulation, 2008 • Government of Canada, Cabinet Directive on Streamlining Regulation, 2007, section 4.6 • Committee of Sponsoring Organizations of the Treadway Commission (COSO), Enterprise Risk Management—Integrated Framework, 2004, section 4: Event identification; section 5: Risk assessment; and section 6: Risk response
The Department of Finance Canada and OSFI keep the regulatory and legislative framework relevant and appropriate in light of emerging domestic and international developments.	• *Office of the Superintendent of Financial Institutions Act* (1985), sections 3.1 and 4 (2) (d) • *Bank Act* (1991), section 21 (1) • Government of Canada, Cabinet Directive on Streamlining Regulation, 2007, section 4.6 • G-20 Leaders' Statement, 2 April 2009, paragraphs 13 to 16 • COSO, Enterprise Risk Management—Integrated Framework, 2004, section 4: Event identification; section 5: Risk Assessment; and section 6: Risk response

To determine whether OSFI assesses the relevance and appropriateness of the supervisory approach and whether it applies it as intended, we used the following criteria:	
Criteria	**Sources**
OSFI periodically reviews the relevance and the application of the existing supervisory approach.	• OSFI, Supervisory Framework, 1999 and beyond • *Office of the Superintendent of Financial Institutions Act* (1985), section 4(2)(a) • Basel Committee on Banking Supervision, Core Principles for Effective Banking Supervision, October 2006, principle 19 • COSO, Enterprise Risk Management—Integrated Framework, 2004, section 4: Event identification; section 5: Risk Assessment; and section 6: Risk response
OSFI keeps the supervisory approach relevant in light of emerging domestic and international developments, including international principles and commitments.	• *Office of the Superintendent of Financial Institutions Act* (1985), section 4(2)(d) • OSFI, Supervisory Framework, 1999 and beyond • G-20 Leaders' Statement, 2 April 2009
OSFI appropriately applies the supervisory approach when assessing the safety and soundness of banks and of the financial system.	• *Office of the Superintendent of Financial Institutions Act* (1985), section 4(2)(a), (b), and (c) • OSFI, Supervisory Framework, 1999 and beyond • G-20 Leaders' Statement, 2 April 2009, paragraphs 13 to 16 • Basel Committee on Banking Supervision, Core Principles for Effective Banking Supervision, October 2006, principles 19, 20, 21, and 23

Management reviewed and accepted the suitability of the criteria used in the audit.

Period covered by the audit

The audit covered the period from 1 November 2007 to 1 November 2009. Audit work for this chapter was substantially completed on 31 March 2010.

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For information, please contact Communications at 613-995-3708 or 1-888-761-5953 (toll-free).

Appendix List of recommendations

The following is a list of recommendations found in Chapter 5. The number in front of the recommendation indicates the paragraph where it appears in the chapter. The numbers in parentheses indicate the paragraphs where the topic is discussed.

Recommendation	Response
Regulation	
5.43 As chair of the Senior Advisory Committee, the Department of Finance Canada should establish the committee's terms of reference, in collaboration with its members. These terms of reference should require the development of plans to perform effectiveness reviews of the regulatory and legislative framework to ensure that significant parts of the regulatory framework are periodically assessed. **(5.37–5.42)**	Agreed. The Department will consider the recommendation to establish terms of reference for the Senior Advisory Committee (SAC), in consultation with the Bank of Canada, the Office of the Superintendent of Financial Institutions Canada, the Canada Deposit Insurance Corporation, and the Financial Consumer Agency of Canada, including giving SAC a mandate to regularly review the effectiveness of the regulatory and legislative framework.
Supervision	
5.59 The Office of the Superintendent of Financial Institutions Canada should update its human resource planning strategy, including specialized training and compensation practices, to ensure that it is in a better position to attract and retain qualified staff. **(5.53–5.58)**	Agreed. The Office is aware that its compensation structure for all positions at the executive level (including, but not exclusively, supervisory staff) is behind the targeted level and was preparing to revise the structure when the *Expenditure Restraint Act* was introduced. The Office has also changed its approach to market data collection to ensure a more quantifiable means of tracking market movement. The Office is also aware of the need to ensure that employees are prepared for emerging risks via opportunistic and timely training. The Office has a comprehensive human resource (HR) planning process that outlines specific strategies to address major opportunities and challenges. Its HR Strategy is revised annually to ensure timely recruitment and retention of the right people with the necessary skills. The HR Plan and Strategy outline the need for the compensation structure to remain competitive and to provide proactive and timely learning opportunities.

Recommendation	Response
	We are reviewing options to bring our salary structure more in line with our historical compensation philosophy. This revised structure will be brought forward for approval in the fall of 2010, with implementation after the expiry of the *Expenditure Restraint Act* in April 2011. For training practices, we will ensure that we focus on specialized areas of risk, while continuing to provide opportunistic training for employees.
Data and information requests	
5.70 As chair of the Financial Information Committee, the Office of the Superintendent of Financial Institutions Canada, in collaboration with committee members, should periodically review regular and ad hoc information requests that it makes to banks to determine whether information collected is relevant, accurate, and sufficient, while carefully assessing the cost-effectiveness of changes to reporting requirements. **(5.67–5.69)**	Agreed. The Financial Information Committee (FIC) has pursued its mandate through a common framework that challenges changes to regular financial data collection and the associated reporting burden. Ad hoc data requests are normally time-sensitive, and, unlike regular data, not conducive to FIC oversight. However, we recognize the need for more formal processes within each agency, and these are under development. By March 2011, the Office will formally implement a Financial Management Information Policy that outlines principles, processes, accountabilities, governance, and oversight for data collection. The treatment of ad hoc data is included in this policy. During the Annual Housekeeping exercise, starting in May 2011, FIC will formally reconfirm and minute the relevance and usefulness of the regular data being collected. FIC will discuss any data that could be eliminated. Also, as part of the Annual Housekeeping process, FIC will engage the banking industry, via the Canadian Bankers Association, on the cost/benefits of a periodic data review exercise and improvements to our ad hoc data collection processes.

Report of the Auditor General of Canada to the House of Commons—Fall 2010

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2010



FALL

Report of the

Auditor General of Canada

to the House of Commons

Chapter 6
Acquisition of Military Helicopters

Office of the Auditor General of Canada



2010



Report of the

Auditor General of Canada

to the House of Commons

FALL

Chapter 6

Acquisition of Military Helicopters

Office of the Auditor General of Canada

The Fall 2010 Report of the Auditor General of Canada comprises Matters of Special Importance, Main Points—Chapters 1 to 9, Appendices, and nine chapters. The main table of contents for the Report is found at the end of this publication.

The Report is available on our website at www.oag-bvg.gc.ca.

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Chapter

6

Acquisition of Military Helicopters

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Acquisition of Military Helicopters

Main Points

What we examined

National Defence is replacing and upgrading its helicopter fleet and will spend nearly $11 billion to acquire two new types of helicopters along with long-term in-service support. The CH-148 Cyclone is a maritime helicopter that will replace the Sea King helicopters; and the CH-147 Chinook is a medium- to heavy-lift helicopter. These modern and technologically sophisticated helicopters are expected to bring new and enhanced capabilities to the Canadian Forces.

Although there are significant differences between the two acquisition projects, both have experienced cost increases and significant schedule delays. For both projects, National Defence has adopted a relatively new approach to providing for long-term in-service support.

We examined how National Defence managed the acquisitions, with emphasis on whether the work to be carried out was described clearly and consistently in key information and decision documents, risks were appropriately assessed and managed, life-cycle costs and plans were complete and timely, and senior departmental boards provided appropriate oversight and approvals. We also examined the contract award process for the projects by National Defence and Public Works and Government Services Canada.

Our conclusions relate only to the management practices and actions of public servants. We did not audit the records of the private sector contractors and, consequently, our conclusions cannot and do not pertain to the contractor's practices or to their performance.

Our access to Cabinet confidences created prior to 2006 is governed by a 1985 order-in-council that permits access only to certain types of Cabinet confidences. Accordingly, we were not provided with information regarding decisions that were made prior to 2006.

Audit work for this chapter was substantially completed on 30 April 2010.

Why it's important

The capabilities that National Defence is seeking to obtain in acquiring the Cyclone and the Chinook helicopters are considered by the Department as essential to the support of Canada's military operations internationally and at home.

The total project cost of 28 Cyclone helicopters, together with initial set-up, training, provision of spare parts and long-term maintenance, is now estimated at $5.7 billion. Delivery of the first fully capable Cyclone, initially expected in 2005, was delayed to 2008 and is now expected to occur in 2012. The total project cost of 15 Chinook helicopters, together with initial set-up, training, and long-term maintenance, is now estimated at more than $4.9 billion. The first fully capable helicopter is scheduled for delivery in 2013, five years later than planned.

Given the cost and complexity of military acquisitions, how they are managed is subject to a number of regulations, policies, and controls designed to ensure that the equipment and services acquired meet the identified needs and are delivered on time and within budget in a way that enhances access, competition, and fairness. Careful planning and full costing of these projects are needed to ensure that all project elements come together in a timely and predictable way and that adequate funds are available over the long term. The demanding acquisition process requires effective leadership, oversight, and due diligence by senior decision makers across several departments. We recognize the significant efforts of many individuals involved in these projects over many years.

What we found

- National Defence underestimated and understated the complexity and developmental nature of the helicopters that it intended to buy. Both helicopters were described to internal decision makers and the Treasury Board as non-developmental, using "off the shelf" technologies. On that basis, overall project risks were assessed as low to medium. In each case, however, significant modifications were made to the basic models. For the maritime helicopter, this will result in an aircraft that never existed before. For the medium- to heavy-lift helicopter, this will result in a new variant of the Chinook. Ultimately, these modifications led to schedule delays and cost increases beyond original plans.
- The medium- to heavy-lift helicopter acquisition was a directed procurement using an advance contract award notice (ACAN). National Defence had initially planned to proceed rapidly to contract award by spring 2007; however, its needs and priorities were not precisely defined at the outset, evolved over the course of the acquisition, and were not finalized until 2009. The manner in which

Public Works and Government Services Canada used the ACAN did not comply with the letter or intent of the applicable regulations and policies and, consequently, the contract award process was not fair, open, and transparent.

- National Defence did not develop full life-cycle plans and costs for these helicopters in a complete or timely way. In addition, total estimated costs were not disclosed to decision makers at key decision points. Some costs have yet to be completely estimated and some elements needed for the capability are not in place. Without adequate cost information, National Defence cannot plan to have sufficient funds available for long-term operation and support of the helicopters. Moreover, without sufficient funds, National Defence may have to curtail planned training and operations.
- National Defence did not fully comply with the oversight and approval framework established in its Project Approval Guide. For the maritime helicopter project, boards provided appropriate oversight at the preliminary project and effective project approval stages. However, neither the Senior Review Board nor the Program Management Board met to challenge and approve the information in the 2008 revised effective project approval that was related to the contract amendment approval of $262 million. For the medium- to heavy-lift helicopter, there was an absence of timely meetings, challenge, and approvals by senior boards at all key decision points in the acquisition process and before seeking Treasury Board approvals.

The entities have responded. The entities agree with all of our recommendations. Their detailed responses follow the recommendations throughout the chapter.

Introduction

6.1 National Defence is replacing and upgrading its helicopter fleet and plans to spend nearly $11 billion to acquire and maintain two new types of helicopters (all figures in this chapter are rounded, in Canadian dollars, and net of GST, unless otherwise stated). These modern and technologically advanced helicopters are expected to bring new and enhanced capabilities to the Canadian Forces.

6.2 The new maritime helicopter will replace the existing CH-124 Sea King. The Sea King entered service between 1963 and 1969 to perform anti-submarine warfare duties in support of Canadian naval surface vessels; the need to replace it was first identified in 1975. A maritime helicopter's capabilities are a vital part of a frigate's ability to protect itself and to exercise surveillance and control well beyond the range of the ship's own sensors and weapons. In 2004, following a competitive procurement, two separate but related fixed-price contracts were awarded to Sikorsky International Operations Inc.: one for $1.8 billion to deliver 28 maritime helicopters and to modify one frigate from which they operate; and one for $3.2 billion to provide initial set-up and long-term **in-service support**. It is planned that Canadian Forces personnel will continue to perform routine maintenance and repair at base and while deployed. The new helicopter was named the CH-148 "Cyclone" in 2004. The new fleet will be located on the east coast at 12 Wing Shearwater and on the west coast at Patricia Bay.

In-service support—Activities required to sustain operation of the helicopter over its lifetime, including engineering, training, inspection, maintenance, and repair of equipment, and provision of spare parts. In-service support may be performed by Canadian Forces or contract personnel while deployed or at base.

6.3 The new medium- to-heavy-lift helicopter (capable of lifting medium to heavy payloads) is intended to provide the Canadian Forces with the ability to move personnel and equipment by air quickly and efficiently in a variety of risk environments at home and overseas. The government's intention to buy these new helicopters was announced in Budget 2005, and the formal acquisition process commenced shortly thereafter. In 2009, a **directed contract** with a $1.4-billion value was awarded to The Boeing Company for 15 "Canadianized" Chinook helicopters. An amendment to this contract is planned in 2013, to provide for long-term in-service support. The new fleet will be located at CFB Petawawa.

Directed contract—A federal government contract awarded to a preselected contractor when the contracting authority can justify setting aside the requirement to solicit competitive bids. The contract must fall under one or more of the exceptions to competitive solicitation in the *Government Contracts Regulations*. Contracting authorities are strongly encouraged to provide public notification of these contracts through an advance contract award notice (ACAN). If this is done and if there are no valid challenges received to the ACAN, the directed contract is deemed to be competitive.

6.4 Buying helicopters is only one part of providing the Canadian Forces with the capability to perform expected missions. Other elements must also be in place to provide the capability and sustain the equipment over its entire life, including qualified and trained personnel to operate and maintain the aircraft, infrastructure to house

the helicopters, and the spare parts needed over the life of the aircraft. The maritime helicopter also requires modifications to the frigates from which they operate. In this chapter a distinction is made, where appropriate, between the costs directly attributable to the acquisition project (including but not limited to third-party contracts) and the total costs associated with the capability.

6.5 For both helicopters, National Defence has adopted a relatively new approach for long-term, in-service support. Although Canadian Forces personnel will provide routine maintenance and minor repairs while at base and while deployed, this new approach involves contracting with the original equipment manufacturer to provide initial set-up and training, spare parts, and major repairs. The approach aims to provide a single point of accountability for maintenance and availability of the fleet.

The acquisition process: Project management and contracting

6.6 Major projects to acquire defence equipment involve several federal departments (Exhibit 6.1).

Exhibit 6.1 Federal organizations with a role in acquiring equipment for National Defence

Organization	Roles and responsibilities
Cabinet	Serves as the ministers' forum for discussion and decision making.
Treasury Board	Approves expenditure authority for projects that exceed ministerial project approval limits. Approves a department's request to enter into contracts. May allow exemptions from Treasury Board policies.
Treasury Board of Canada Secretariat	As the Treasury Board's administrative arm, develops policies and guidance for the federal government in such areas as project management and contracting. Provides advice and assistance to departments in preparing submissions to the Treasury Board and challenges submission content.
National Defence	Initiates and manages acquisition projects. Defines project requirements. Analyzes and recommends options. Proposes a procurement strategy. Prepares statements of work and plans for technical evaluation of bids. Performs quality assurance, receives goods, and authorizes payments.
Public Works and Government Services Canada	Manages the contracting process. Conducts market analysis of industry availability and capacity. Develops final procurement strategies. Prepares bid documents and conducts tendering processes. Awards and administers contracts.

6.7 Such major equipment acquisition projects are subject to legislation, Treasury Board policies, and various departmental guides and manuals. Together they aim to ensure that the projects are managed effectively and economically, that the equipment and related services are acquired in a way that enhances access, competition, and fairness, and that they result in best value. They specify key steps to be followed, types of information and mandatory documents required, and approvals that must be obtained as an acquisition project progresses through the project management and contracting phases (Exhibit 6.2). Key project information tracked through the phases of the project includes operational requirements, cost, risks, and delivery schedule.

6.8 A number of boards in National Defence are involved in providing project oversight and approvals.

- **Program Management Board**—has overall responsibility for approving projects and for monitoring project performance.
- **Joint Capability Requirements Board**—reviews and endorses technical and operational requirements of projects.
- **Senior Review Board**—is established for each large project to provide rigorous examination of and challenge to a project and ongoing review and oversight.

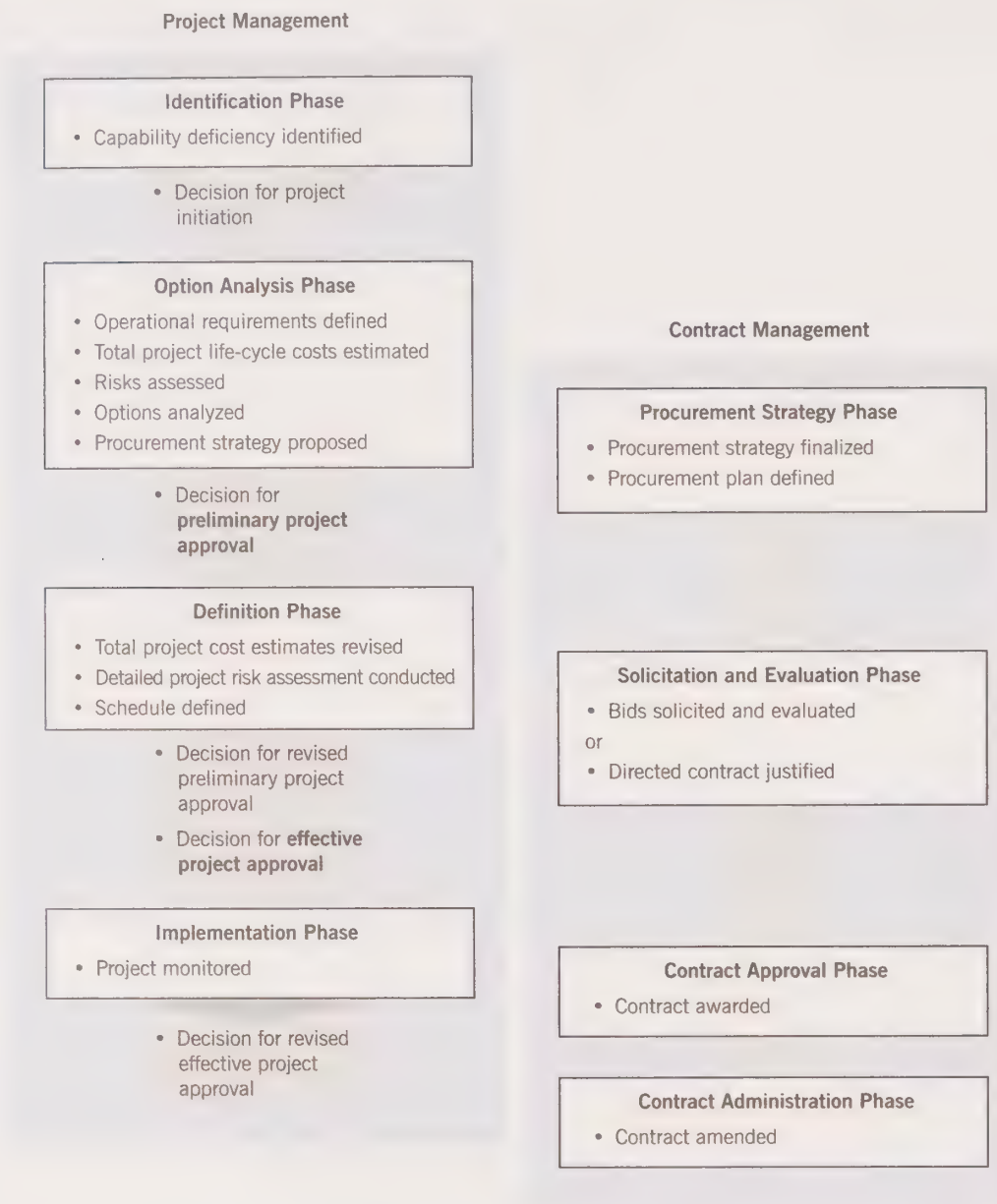
6.9 For projects greater than $100 million, an interdepartmental Senior Project Advisory Committee is also established to perform the role of a procurement review committee and to serve as a forum for reviewing and discussing project objectives, requests for proposals, and other key project instruments.

6.10 The acquisition of new, technologically sophisticated and expensive capability for the Canadian Forces is a significant challenge in government procurement. The demanding acquisition process requires effective leadership, oversight, and due diligence by senior decision makers across several departments. We recognize the significant efforts of many individuals involved in these projects over many years.

Focus of the audit

6.11 This audit examined whether National Defence and Public Works and Government Services Canada (PWGSC) managed the acquisition of the maritime and the medium- to heavy-lift helicopters in compliance with selected key provisions of applicable regulations and policies. Specifically, these are: the *Government Contracts Regulations*; the Treasury Board's Project Management Policy,

Exhibit 6.2 **Key phases, steps, approvals, and documents in government project and contract management**



Preliminary project approval—Within National Defence, internal approval in principle for the preferred option at the estimated cost and to proceed to the project's definition phase. Within the Treasury Board, authorization to expend resources for the project's definition phase. Submissions at this phase are expected to include the indicative estimate of total project cost, including life-cycle costs.

Effective project approval—Within National Defence, internal approval for the selected option and to proceed to the project's implementation phase. Within the Treasury Board, expenditure authority to implement the project. A substantive total project cost estimate based on higher quality and reliability is expected to be included in supporting documentation.

Note: This exhibit presents an adapted version of the project management process used within National Defence and the contract management process used within Public Works and Government Services Canada in acquiring military equipment. Each process is presented separately but some activities happen concurrently.

Project Approval Policy, Policy on the Management of Major Crown Projects, and Contracting Policy; the PWGSC Supply Manual; and National Defence's Project Approval Guide. These documents define expectations for the processes, key phases, and approvals required in managing major Crown projects and awarding and administering contracts. More specifically, we examined whether

- technical and operational requirements were clearly defined and consistently adhered to,
- risks were appropriately assessed and managed,
- life-cycle plans and costs were identified,
- key decisions were supported by complete and accurate information, and
- appropriate and timely approvals were obtained.

We placed particular emphasis on the oversight role played by senior committees and boards.

6.12 Although the maritime helicopter project began in 1995, the activities we audited occurred between 1999 and 31 March 2010. The audit of the medium- to heavy-lift helicopter project covered activities between January 2005 and 31 March 2010.

6.13 More details about the audit objectives, scope, approach, and criteria are in **About the Audit** at the end of this chapter.

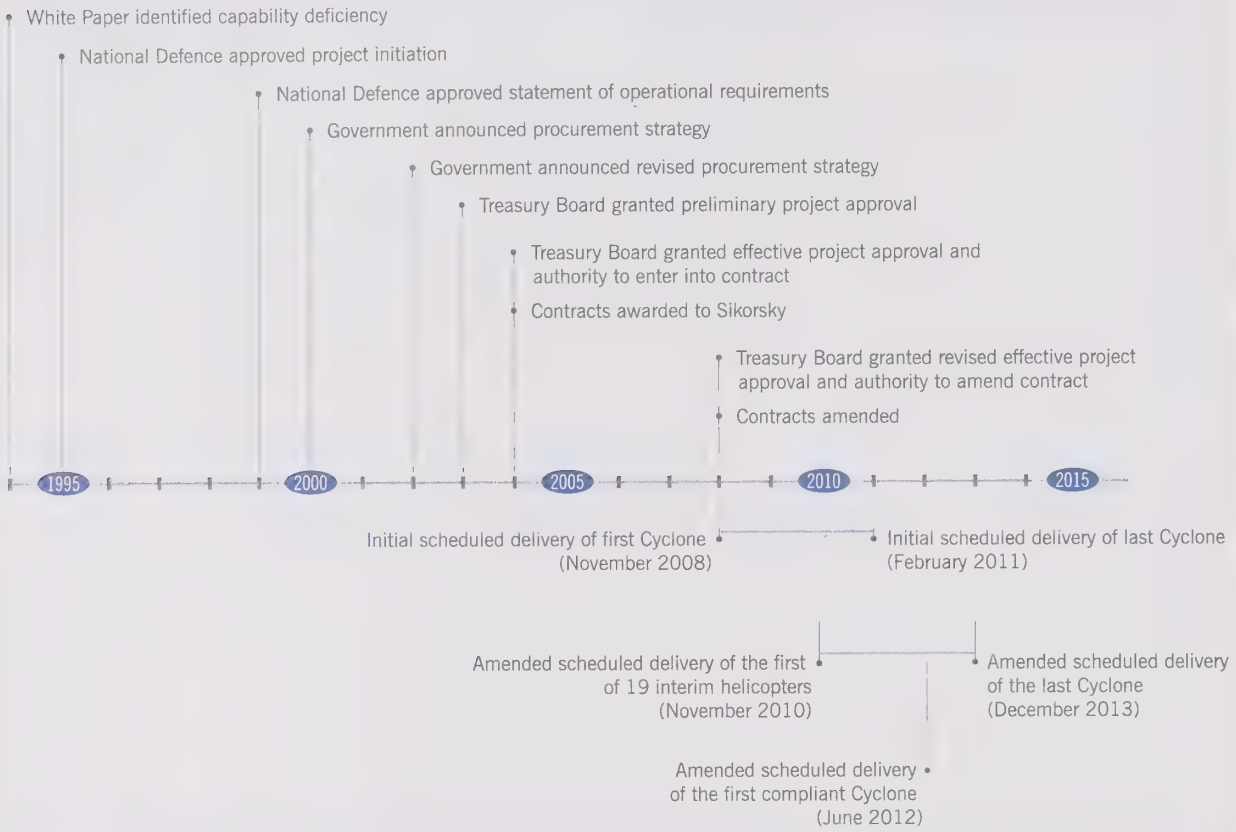
Observations and Recommendations

6.14 Our observations are presented separately for the two helicopter projects, the Cyclone and the Chinook. Our recommendations are provided in the section on the Chinook helicopter, but are meant to apply to both helicopter projects.

Maritime Helicopter Project—Cyclone

6.15 The process to replace the Sea King helicopters started nearly 25 years ago. A first attempt began in 1986 and resulted in a contract to purchase the EH-101. This contract was cancelled by the government in 1993 at a cost of $478 million. The acquisition process started again in 1995 as the Maritime Helicopter Project. As stated in the 1994 Defence White Paper, "Sea Kings are rapidly approaching the end of their operational life. There is an urgent need for robust and capable new shipborne helicopters." The process is still underway (Exhibit 6.3).

Exhibit 6.3 Timeline of key announcements and approvals for the maritime helicopter project—Cyclone



6.16 Noteworthy in this acquisition are the use of a competitive procurement process leading to the award of two contracts to Sikorsky International, the announcement in 2008 of a 30-month delay in the delivery of the helicopters, and the negotiation of a major contract amendment. Subsequent to the completion of our audit work for this chapter, Public Works and Government Services Canada executed a second major amendment to the contract with Sikorsky on 30 June 2010 (see paragraph 6.34).

Total indicative costs A rough cost projection used for budget planning purposes in the early stages of a project, based on the operational requirements, a market assessment of products technological availability, and life-cycle costs.

6.17 In 2000, total indicative costs of the 28 maritime helicopters were estimated at $2.8 billion and revised to $3.1 billion in 2003, exclusive of the cost of providing in-service support. The cost of purchasing and providing in-service support for the helicopters, and of training personnel, is currently estimated to be $5.7 billion over 20 years. This estimate does not include costs related to contracted Sea King support, new infrastructure, Canadian Forces personnel, and ongoing operating

costs. In addition, the project has experienced delays. Delivery of the first fully capable Cyclone, initially expected in 2005, was delayed to 2008 and is now expected to occur in 2012.

Changes in contract provisions are not consistent with the procurement strategy

6.18 A basic principle of government procurement is that to ensure openness and fairness, project requirements should be defined consistently across the key contracting documents—**statement of operational requirements**, detailed specifications for the supplier selection process, the request for proposals, and contract amendments—and should not change significantly during the selection process or after a contract is awarded. This is particularly so with respect to this acquisition, given that the procurement strategy was based on awarding the contract to the lowest price bid that complies with the stated requirements. We examined whether the project requirements were described consistently in key information and decision documents and the nature and justification of the contract amendment. We also examined the basis for the chosen procurement strategy; however, we were unable to reach a conclusion on this due to limits to our access to Cabinet confidences prior to 2006 (see paragraph 6.96).

Statement of operational requirements—A document stating characteristics that must be delivered for the project to satisfy the needed capability; contains the critical performance criteria necessary to evaluate technical options.

6.19 Between 1995 and 1999, National Defence conducted options analyses and recommended the procurement of new helicopters to fill the capability deficiency identified in 1994. The statement of operational requirements was approved in 1999. These were subsequently converted into detailed specifications needed for the procurement process. Only requirements deemed essential were included in the final specifications. An independent review conducted for National Defence found that the operational requirements were adequately translated into the detailed specifications used during the selection process. We performed a similar analysis of selected operational requirements and reached similar conclusions.

6.20 In 2000, two options for procurement strategies were under consideration. One was for a single competition to select a supplier of the combined airframe and mission systems; the other was for two competitions, splitting the **airframe** and **mission systems**. National Defence and Public Works and Government Services Canada (PWGSC) assessed the pros and cons of each strategy for government consideration. The government chose to have two competitions. In the fall of 2000, PWGSC issued a letter of interest that sought to identify those companies interested in bidding to become the prime contractor for the airframe or the mission systems.

Airframe—The structural components of an aircraft, such as fuselage, empennage, wings, landing gear, and engine mounts, but excluding such items as electronics and other parts that may be replaced from time to time.

Mission systems—Suite of sophisticated electronic sensors integrated to support the operational role of the aircraft, may include surveillance and navigational control.

6.21 In late 2002, the Minister of National Defence announced a major change in the procurement strategy: The helicopters would be purchased through a single competitive process to acquire 28 fully equipped helicopters. A second letter of interest was subsequently issued. In effect, the acquisition process was restarted, which resulted in a two-year delay.

6.22 A pre-qualification process was undertaken in March 2003, based on detailed technical specifications, and two manufacturers were deemed technically compliant. Each subsequently submitted a full bid in response to the request for proposals. The bids were evaluated based on compliance with the technical requirements, industrial and regional benefits, and lowest overall price. In July 2004, the government announced the winner as Sikorsky International Operations Inc. and two contracts (for the acquisition and the service support) were awarded shortly thereafter. Between 2004 and 2007, National Defence had regular progress meetings with Sikorsky on the status of the project.

6.23 In early 2008, Sikorsky informed PWGSC of a 30-month delay in the planned delivery of the helicopters, citing, among other things, additional work directed by or caused by the Crown (the departments) and the challenges associated with obtaining certification for a technical component in the new helicopter. This led to a contract amendment in 2008, which allowed for a delay in the delivery of the first fully capable helicopter to June 2012, 43 months after the original contract's delivery date. PWGSC negotiated with the contractor for delivery of up to 19 interim helicopters starting in November 2010. These interim helicopters will not fully meet all of the operational requirements, in particular the mission endurance performance of two hours and 50 minutes, and will have to be retrofitted at a later date. While the interim helicopters will be suitable for testing, evaluation, and training, they will not be deployed on operations. The amendment extended the time period for providing in-service support by two years and amended the provisions contained in the original contract that set out damages associated with late delivery to coincide with the new delivery schedule.

6.24 The amendment also provided for additional "power reserve" (more powerful engines) to meet the mission endurance performance requirement and to accommodate a potential growth in performance in the future. According to PWGSC, this increased the cost of the contracts by about $84 million for the growth potential.

6.25 This amendment is significant in principle because the procurement strategy, which was communicated to industry, was based

on the lowest-price bid that met the stated (essential) requirements. The process did not give any credit to bids, or portions of bids, that exceeded the stated requirements. National Defence has, in effect, acknowledged that there is value in acquiring a helicopter with this additional power reserve and is now paying for more capability than it said it needed at the time the contract was signed. It should be noted that the in-service support contract with the manufacturer specifically requires that it maintain the aircraft's endurance performance at the desired level throughout the life of the helicopter and contract period. Consequently, in our opinion, the contract amendment is not consistent with the original lowest price compliant procurement strategy. It also raises the question as to whether a lowest price compliant strategy is compatible with the acquisition of complex military equipment requiring significant development.

The developmental nature of the helicopter was underestimated

6.26 The Treasury Board's Project Management Policy requires that a **project profile and risk assessment** be prepared early in a project to document the level of risk and to develop a corresponding risk mitigation strategy. The project's overall risk level is to be assessed as high, medium, or low, depending on the size, scope, and complexity of the project, and is to be reassessed periodically throughout the life of the project. We examined whether National Defence appropriately assessed the risks entailed in the acquisition of the Cyclone helicopter and developed a strategy to mitigate them.

Project profile and risk assessment—A document that states the technical, cost, and schedule risks and outlines the management strategy to deal with them.

6.27 The assessment of technical, cost, and schedule risk is closely tied to the complexity and developmental nature of a planned acquisition. Terminology is important in this regard, and it is helpful to think in terms of a spectrum from "off-the-shelf" to "developmental" equipment or technology. Off-the-shelf equipment is typically an existing product that is ready for delivery as is. Developmental equipment is typically a product that does not yet exist. In between these extremes are various degrees of modification to an existing product or integration of existing technologies. According to National Defence, a "simple" procurement typically involves an off-the-shelf product of low dollar value with fully defined requirements, and the absence of political sensitivity; whereas a "complex" procurement involves a complex statement of work, many systems and elements to bring together, significant resource constraints and trade-offs, and many players.

6.28 National Defence began preparing the maritime helicopter project profile and risk assessment in 2000. It was presented to its Senior Review Board, though there is no record that it was approved as

required. As part of the preliminary project approvals in 2003, a revised assessment was prepared and approved within National Defence and was summarized for presentation to the Treasury Board. We could find no evidence that a formal assessment was prepared in support of the 2004 effective project approval or the 2008 revised effective project approval. The overall project risks were assessed in 2000 as low to medium, an assessment that continued through key approvals in 2003 and 2004.

6.29 As early as 2000, information provided to National Defence's Program Management Board for preliminary project approval described the proposed acquisition project as non-developmental, using a commercial off-the-shelf airframe and mission system technologies, advising that Canada would not be the first buyer. The 2000 letter of interest issued to potential suppliers required maximum use to be made of non-developmental off-the-shelf equipment. The 2003 preliminary project approval submission to the Treasury Board informed ministers that operational requirements were written to take advantage of existing technology and that potential manufacturers have confirmed their ability to deliver a non-developmental helicopter in the time frame required. The 2004 effective project approval submission informed ministers that the airframe and mission systems were non-developmental but also acknowledged that potential technical difficulties may arise with modifying the helicopter or integrating the mission systems.

6.30 However, it is evident that this was to be a complex procurement. The project specifications included nearly 3,000 technical requirements. The winning bid by Sikorsky was to convert an existing commercial helicopter (the S-92) to military service, adapt it for marine use, and integrate numerous individual existing mission components and new technologies. According to National Defence officials, this will result in a state-of-the-art helicopter that has never existed before. The initial acquisition contract reflects this complexity in that it included $612 million for one-time engineering costs. National Defence and PWGSC sought and received approval from the Treasury Board to spend up to $659 million to cover such costs as part of the 2008 revised effective project approval submission. In our opinion, National Defence has, in effect, entered into an agreement with Sikorsky to develop a new helicopter and this should have been reflected in project risk assessments and in information provided to decision makers.

6.31 For the pre-qualification process managed by PWGSC, potential bidders were required to submit "proof of compliance" for 476 of the 3,000 technical requirements that were deemed to pose a higher risk; this involved providing reports, plans, and/or drawings describing in

detail how the requirements would be met. The extent to which the contractor's proposals met the stated requirements was assessed as part of the evaluation. No consideration was given to solutions that were already in existence (off-the-shelf) versus those requiring modification or development. In our opinion, this pre-qualification process did not adequately consider the significant technical risk associated with the developmental nature of this helicopter.

6.32 The developmental nature of the Cyclone helicopter, along with its novel features, also has implications for certifying its airworthiness. The selection process required airworthiness certification of the basic commercial helicopter at the time of the contract award and certification of the new aircraft when the first one was delivered. However, the complexity of the new aircraft has led to unanticipated certification requirements and a potential unforeseen role for National Defence in undertaking certain aspects of the certification.

Airworthiness certification—A document issued by a government body certifying that the design of an aircraft meets the applicable standards for that product. A certificate of airworthiness is issued for an aircraft that conforms to its certified type design and is safe for flight in Canadian airspace.

6.33 In our opinion, National Defence did not adequately assess the developmental nature of this aircraft, and the risks related to cost and the complexity of the required technical modifications were underestimated. In addition, the original delivery schedule (48 months after contract award) and the identified risk related to the potential for delays were not consistent with the developmental nature of this acquisition. (See paragraphs 6.64 and 6.65 for our recommendations).

6.34 As noted in paragraph 6.16, subsequent to the completion of audit work for this chapter, the contract with Sikorsky was amended a second time on 30 June 2010, providing for delivery of "redefined" interim helicopters. These interim helicopters will not be fully compliant in areas that reflect difficulties associated with the developmental nature of the helicopter, such as the mission system software and the exchange of tactical data between the ship and the aircraft. PWGSC informed us of this amendment in July 2010.

Full life-cycle costs, including in-service support, have not yet been determined

6.35 The Treasury Board Contracting Policy states that inherent in procuring best value is the consideration of all relevant costs over the useful life of the equipment, not solely the initial acquisition or basic contract cost. Moreover, National Defence's Project Approval Guide requires an estimation of total indicative costs when seeking preliminary project approval and total substantive costs for effective project approval. We recognize the challenges associated with estimating costs in such major acquisitions, particularly at the preliminary project approval phase, and that costing information is expected to become

Total substantive costs—A cost projection based on a sufficiently high degree of quality and reliability to support project approval for the specified deliverables and time frame of the project

more precise over time. Careful planning and full costing are needed to ensure that all of the elements required to provide the needed defence capability come together in a timely and predictable way and that adequate funds are available to support the equipment over the long term. In the case of the maritime helicopter, start-up and arrival of the Cyclone must also be coordinated with modifications to the frigates and with the transition from the Sea King helicopter.

6.36 We examined whether information presented to decision makers was complete and accurate and whether approvals were given according to key provisions of legislation and National Defence and government policies and guidelines. This included project costing information contained in Treasury Board submissions and information presented to National Defence's Program Management Board.

6.37 We found that National Defence has been slow to assess the full life-cycle costs, and some elements of these costs have still not been completely determined. In 2000, total indicative costs of the 28 maritime helicopters were estimated at $2.8 billion, and this was revised to $3.1 billion in 2003, exclusive of the cost of providing in-service support. The cost of purchasing and providing in-service support for the helicopters, and of training personnel, is currently estimated to be $5.7 billion over 20 years, an estimate that does not include costs related to contracted Sea King support, new infrastructure, Canadian Forces personnel, and ongoing operating costs. Consequently, the full life-cycle costs were not—and some still have not been—presented to decision makers at key decision points (Exhibit 6.4). Without such information, National Defence cannot adequately plan to have sufficient funds available for long-term operations and support of the helicopter. Moreover, without sufficient funds, National Defence may have to curtail planned training and operations.

6.38 For example, in the 2003 submission to the Treasury Board for preliminary project approval, National Defence should have presented estimated costs for infrastructure, personnel, and operations and maintenance or contracted in-service support. In fact, in reviewing the planned submission, National Defence's Program Management Board noted the absence of this information and raised concerns about sources of funding for future operations and maintenance and the assessment of infrastructure costs. These concerns triggered subsequent discussions about the affordability of the Cyclone and of means to reduce costs, including the possibility of reducing the number of flying hours.

6.39 Estimating costs for long-term in-service support was especially challenging. Until 2003, National Defence assumed that costs for

personnel, operations, and maintenance would be offset in whole or in part from the Sea King expenditures. No additional or incremental costs were identified in seeking preliminary project approval. On the basis of the bid received from Sikorsky, $2.3 billion in estimated costs for contracted in-service support for 16 years (based on flying 10,000 hours annually) was presented for effective project approval in 2004. By this time, National Defence realized that personnel, operations, and maintenance costs would exceed those associated with the Sea King by $1.1 billion over 20 years. This is significant because

Exhibit 6.4 Estimated cost information for the maritime helicopter presented in the Treasury Board submissions

	Preliminary Project Approval June 2003	Effective Project Approval November 2004	Revised Effective Project Approval December 2008
	(In millions of Canadian dollars)*		
Capital costs			
Maritime helicopter	1,850	1,690	1,529
Ship modifications and other equipment	191	193	282
Initial set-up (includes engineering, provision of spares, training facilities)	819	838	815
Project management	158	156	210
Contingency and escalation/inflation	98	297	130
Infrastructure	not included	not included	not included
Growth potential and other costs	n/a	n/a	208
Total capital costs	**3,116**	**3,174**	**3,174**
Personnel, operating, and maintenance costs			
Contracted in-service support	not included	2,346	2,495
National Defence personnel	not included	not included	not included
National Defence operating costs	note 1	note 2	not included
Total personnel, operating, and maintenance costs	—	**2,346**	**2,495**
Total costs	**3,116**	**5,520**	**5,669**

Notes:

1. The Treasury Board submission noted that the in-service support concept was to be more clearly identified.
2. The Treasury Board submission noted that total operations and maintenance costs for the Cyclone would be $900 million more between the fiscal years 2011–12 and 2022–23 than for the Sea King.

* Figures have been rounded.

Source: Key approval documents; unaudited figures

National Defence did not seek additional funding for the in-service support provisions, so these incremental costs will need to be covered by its existing operations and maintenance budget. Given the fixed budget for maintenance, National Defence has observed that it may have to take measures to reduce the pressure on this budget, including reducing the number of anticipated flying hours.

6.40 For land-based infrastructure, National Defence initially assumed that, despite known deficiencies, the hangars and other facilities used for the Sea King helicopters could be used for the new helicopters, thus no cost estimates were presented as part of the preliminary project, effective project, or revised effective project approvals. In 2005, however, National Defence determined that there was a need for significant investment in new infrastructure. It has since initiated approximately $340 million in projects for maintenance, spare parts warehousing, training, and squadron facilities. These projects were subject to separate Treasury Board and departmental submissions and approvals, which stressed the link to the delivery of the Cyclone helicopter.

6.41 There was also a need to extend the life of the Sea King helicopters longer than originally anticipated as a consequence of delays in the Cyclone project. This resulted in further costs. Specifically, a third-party contract was signed by National Defence in 2003 for the repair and overhaul of the Sea King until March 2008. An option to extend the period was exercised in November 2007 for an additional $168 million to cover the period up to 2014. The extension coincided with the notification that the delivery of the Cyclone helicopters would be delayed.

6.42 Taking into account all direct and related costs associated with the Cyclone capability, we estimate the total costs to be in the order of $6.2 billion exclusive of National Defence personnel and operating costs. (See paragraphs 6.74, 6.75, and 6.76 for our recommendations).

There were gaps in oversight and approvals by senior boards

6.43 In approving large capital acquisitions, National Defence is expected to follow its Project Approval Guide and the Treasury Board's Project Approval Policy to ensure that risks are minimized and the acquisition meets the stated requirements. We focused on information that was presented internally and to the Treasury Board—as well as the role played by key boards within National Defence—for key approvals of the project, namely at the identification, preliminary project, effective project, and contract approval phases. This included approval

documents, records of decisions, and minutes of meetings. We recognize that oversight within National Defence is provided by both individuals serving in senior positions and by designated boards (on which these individuals may sit).

6.44 Of the key decision points in the approval process for a major Crown project, we found that the National Defence boards provided appropriate oversight at the preliminary project and effective project approval stages. However, neither the Senior Review Board nor the Program Management Board met to challenge and approve the information in the 2008 revised effective project approval related to the contract amendment approval of $262 million. Though we were provided evidence that senior personnel signed off on the key decision documents, the absence of board involvement is important because significant changes to the cost, scope, and schedule of the project were decided without the review and challenge the board provides, as intended in the Project Approval Guide. In addition, as the project moved through the implementation phase, there were gaps in the monitoring of the project performance between May 2007 and March 2010 by the Senior Review Board.

6.45 There is also no record that the Senior Review Board met to challenge and approve other key documents such as the project charter, statement of operational requirements, and project profile risk assessments. The information contained in these documents later became part of the documents submitted for project approvals within National Defence and the Treasury Board. It is important for effective project management that internal and external decision makers have a holistic view of the project and a forum to discuss and assess project risks and performance.

6.46 Without ongoing board oversight or approvals, the maritime helicopter project is not being managed in accordance with the Project Approval Guide and the Treasury Board's Project Approval Policy (see our recommendation at paragraph 6.92).

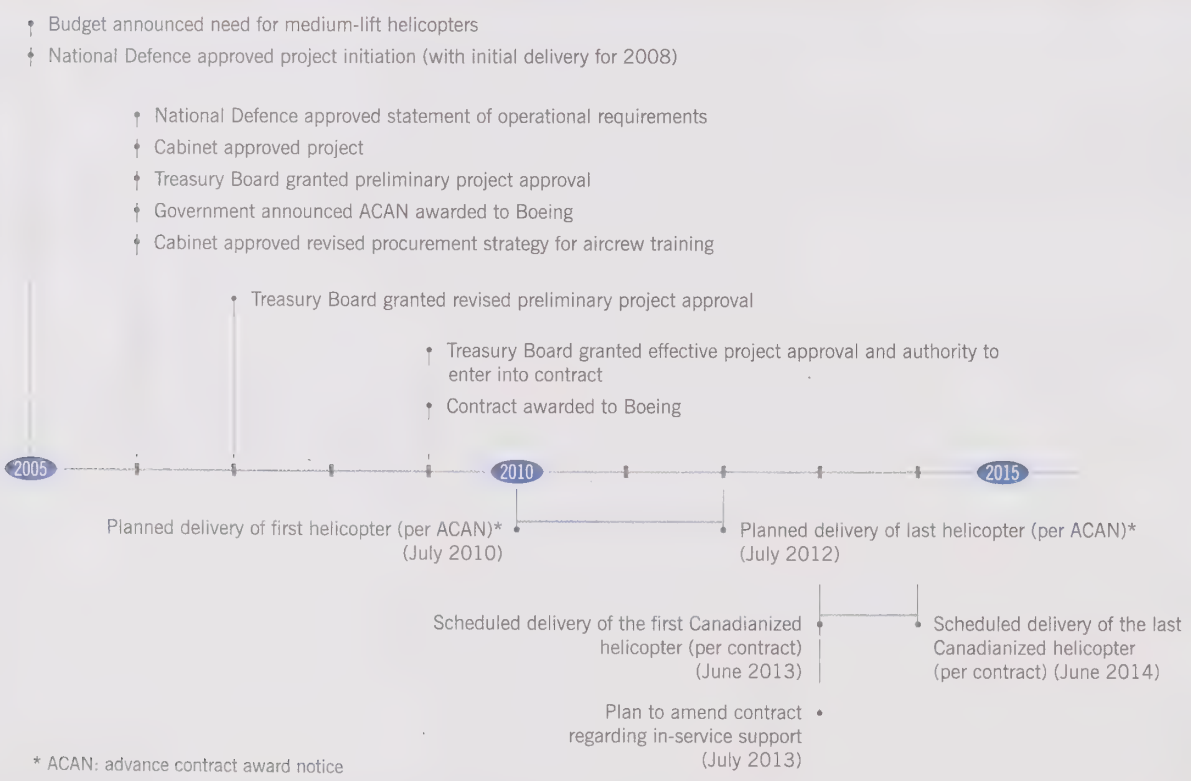
Medium- to Heavy-Lift Helicopter Project—Chinook

6.47 The Boeing Chinook helicopter is well known and in use by militaries around the world. Canada once owned and operated a fleet of Chinooks, but these were sold in the 1990s. With this project, National Defence is building a new capability of medium- to heavy-lift helicopters from the ground up. Among other things, there is a need for suitable facilities to house the fleet, personnel to maintain the aircraft, and pilots to fly them. Noteworthy in this acquisition are its rapid start-up and aggressive schedule following the 2005 Budget

announcement, a directed contract awarded to The Boeing Company, use of an advance contract award notice (ACAN) instrument, and the as yet undetermined provisions and costs for in-service support. Exhibit 6.5 provides a timeline of key events.

6.48 In 2006, at the preliminary project approval stage, total indicative costs for the acquisition of 16 medium- to heavy-lift helicopters were estimated at $2 billion, exclusive of long-term in-service support. The cost of purchasing and providing in-service support for 15 helicopters, and of training personnel, is currently estimated to be $4.9 billion over 20 years, which does not include ongoing operating costs and the costs of the nearly 500 Canadian Forces personnel required to operate and maintain the fleet. In addition, planned delivery of the first fully capable Canadianized Chinook has been delayed from 2008 to 2010, and then again to 2013, and the number of helicopters being purchased has been reduced from 16 to 15.

Exhibit 6.5 Timeline of key announcements and approvals for the medium- to heavy-lift helicopter project



Precise needs and helicopter specifications were not defined early enough

6.49 As noted for the maritime helicopter project, project requirements should be defined consistently across the key contracting documents and should not change significantly during the procurement process. We examined whether the work to be carried out was described clearly and consistently in key information and decision documents. It should be noted that following the budget announcement, National Defence had planned to proceed rapidly through the options analysis and definition phases of this acquisition, anticipating contract award as early as the fall of 2006. We found that National Defence's needs and priorities were not precisely defined at the outset and evolved over the course of the acquisition. They were not finalized until the contract with Boeing was signed in 2009.

6.50 The February 2005 Budget announcement highlighted the need for helicopters capable of moving personnel and equipment around in the field and in a variety of domestic and international situations. The project entered the options analysis phase in July 2005 following approval by National Defence of a broadly worded one-paragraph statement of capability deficiency. This statement highlighted a gap in helicopter support to the Land Forces in conditions like Afghanistan and also noted the need to support new task force structures then being considered. From the outset, National Defence said the helicopters were intended to serve multiple missions, which evolved from initially supporting "high, hot and heavy" operations in places like Afghanistan to eventually supporting domestic requirements in the Arctic.

6.51 Soon after the 2005 Budget, National Defence met with The Boeing Company in order to obtain detailed information about its Chinook helicopter, such as the available configurations and technological options and their associated costs. Through 2005 and 2006, additional meetings were held with Boeing and the exchange of technical and costing information continued. During this period, National Defence also conducted a market analysis by obtaining information about other helicopters, largely based on literature review.

6.52 In June 2006, National Defence approved the statement of operational requirements. It identified the following seven high-level mandatory requirements:

- internal lift capacity: ability to carry 30 soldiers and full combat equipment weighing a total of at least 4,763 kilograms;

- external lift capacity: ability to lift multiple loads, weighing a total of at least 5,443 kilograms;
- minimum flying range of 100-kilometre radius with either the internal or external payload outlined above and at the temperature and altitude set out below;
- able to provide the lift and flying range outlined above at a temperature of 35°C and altitude of 1,220 metres above sea level;
- airworthiness certification of the aircraft to standards recognized by Canada by contract award date;
- minimum fleet size of 16 helicopters, to be housed at two main operating bases; and
- delivery of the first aircraft no later than 36 months after contract award and delivery of the final aircraft no later than 60 months after contract award.

These were the minimum requirements that a helicopter would need to meet and were intended for use as market discriminators in the procurement process. The statement also included 136 "rated" requirements without which, according to National Defence, operational capabilities would be "seriously diminished." An aggressive delivery schedule was planned for the helicopters, noting the importance of an "off-the-shelf" solution to meet these needs. The new helicopters were to be housed at two main operating bases. The statement of operational requirements was not reviewed or endorsed by the Senior Review Board or by the Joint Capability Requirements Board until October 2006 and, consequently, did not benefit from the rigorous challenge these bodies are expected to provide.

6.53 By June 2006, based on meetings and discussions with Boeing and the market analysis, National Defence had formally concluded that Boeing's Chinook was the only existing Western certified helicopter in production capable of meeting its needs. It subsequently recommended to the interdepartmental Senior Project Advisory Committee to employ an **advance contract award notice (ACAN)**. The Committee endorsed this procurement strategy prior to preliminary project approval submission to the Treasury Board, while expressing concern about the ability to meet the planned aggressive schedules.

Advance contract award notice (ACAN)—A notice posted by departments and agencies for no less than 15 calendar days, indicating to the supplier community that it intends to award a good, service, or construction contract to a pre-identified contractor. If no other supplier submits, during the posting period, a statement of capabilities that meet the requirements set out in the ACAN, or if suppliers were not successful in demonstrating that their statement of capabilities meets the requirements set out in the ACAN, the contract may then be awarded.

6.54 Also in June 2006, National Defence sought and received preliminary project approval from the Treasury Board, thereby starting the project's definition phase. National Defence informed the Treasury Board that a contract was expected to be awarded between the

fall of 2006 and the winter of 2007. The ACAN, posted in July 2006, included a revised anticipated contract award date of July 2007. After the closing of the ACAN, National Defence worked with Boeing to develop a detailed statement of work that would be the basis for the request for proposal to which Boeing would provide a bid. Achieving this aggressive schedule would have required that National Defence knew precisely the type of missions the helicopter would support, what it wanted the helicopter to do, and the technical specifications needed to achieve it.

6.55 This precise information was not in place at the time, and this affected the subsequent process of detailing specific needs and priorities. Evidence on file indicates uncertainty, before and after June 2006, regarding which types of operations were to be supported (whether land, maritime, or special operations), what mission systems would be needed, the minimum number of helicopters, and whether the helicopters would be located at one or two main operating bases.

6.56 The intended configuration of the Canadianized Chinook evolved as decisions were made about the operations it would support and about the number and location of operating bases, and as the costs associated with modifying the helicopter to meet the operational needs became clearer through discussions with Boeing. There are several models or variants of the Chinook helicopter, with different features and capabilities. According to National Defence, the seven high-level mandatory requirements could have been met by a basic Chinook model. However, in the process of detailing its specifications with Boeing, National Defence also drew from the set of rated operational requirements, effectively treating extended-range fuel tanks, an upgraded electrical system, and aircraft survivability equipment as mandatory requirements, though none had been originally identified as such. These additional modifications resulted in significant changes to a basic Chinook model and also had an impact on the timing and complexity of certification for airworthiness.

6.57 In March 2007, Boeing informed National Defence that accommodating these additional requirements would cause a delay in the delivery of the helicopter. Canadian-requested modifications also caused an increase in the cost. In an attempt to stay within the project expenditure authority approved by the Treasury Board, National Defence had to subsequently re-examine its needs in an exercise to reduce the project scope. The process to define the detailed statement of work for the request for proposal added more than two years to the contracting process than was originally planned and presented to

the Treasury Board for approval in 2006. Ultimately, National Defence's requirements were not finalized until 2009 when the contract with Boeing was signed. By the time the contract was awarded in 2009, one of the seven high-level mandatory requirements had been changed (minimum fleet size) and two would not be met (airworthiness certification and scheduled delivery of the first Canadianized Chinook, which had both been delayed).

The full extent of modifications were not initially presented to decision makers

6.58 As noted in paragraph 6.27 for the maritime helicopter project, the assessment of technical, cost, and schedule risk is closely tied to the complexity and developmental nature of a planned acquisition. In our opinion, National Defence understated the complexity of configuring this helicopter. In effect, Canada is purchasing a new variant of the Chinook helicopter that requires significant modifications to meet National Defence's requirements and needs.

6.59 In 2006, the project was described by National Defence internally and to Cabinet and the Treasury Board as an off-the-shelf procurement, taking advantage of helicopters in production and incorporating existing technologies. Canadian-requested modifications were to be adopted only where essential. This was the basis of the information on risk, cost, and schedule presented for preliminary project approval. Risks were generally assessed as "low" to "medium," although a formal project profile and risk assessment was not finalized or approved at this stage, or in fact at any of the three key project approval points, as required.

6.60 We disagree with the characterization of this helicopter as being off-the-shelf. It is evident that from the beginning, National Defence did not intend to procure an off-the-shelf Chinook but rather a modified one that included, among other things, extended-range fuel tanks, an upgraded electrical system, and aircraft survivability equipment. While these components existed in other Chinook models, they had never been incorporated in the Canadianized model the Department was seeking. Documentation within National Defence describes the inclusion of extended-range fuel tanks as requiring "major structural changes." Other modifications were unique to the Canadianized Chinook. Detailed technical information and assistance were needed in order to understand the impact of the required Canadian modifications.

6.61 In March 2007, Boeing informed Public Works and Government Services Canada (PWGSC) and National Defence that the delivery

schedule would need to be extended by an additional 12 months to allow for airworthiness and safety certification of the aircraft. So significant were the modifications to the basic Chinook helicopter that Boeing's estimate included nearly US$360 million for one-time engineering costs. The extent of changes is further evidenced by the fact that the final contract awarded to Boeing includes a provision for Canada to recover some costs should another customer purchase the Canadianized version in the future.

6.62 National Defence knew, prior to seeking preliminary project approval from the Treasury Board and issuing the ACAN, that significant modifications to a basic Chinook were desired and planned. It knew also that these would increase the risks to cost and schedule. However, this was not presented to the Treasury Board when seeking preliminary project approval but should have been. We observed that the information provided to the Treasury Board when seeking effective project approval in 2009 more clearly and fully described the nature of the modifications and associated risk. Ultimately, Canadian-required modifications increased the cost of each aircraft by 70 percent more than initially quoted by Boeing in early 2006. This prolonged the negotiation of the contract by over two years and delayed the delivery of the aircraft.

6.63 The procurements of the Chinook and Cyclone helicopters raise the question of whether it is realistic to expect to be able to acquire complex pieces of military equipment that meet Canada's unique needs using strictly off-the-shelf technologies and using a lowest price compliant strategy. It needs to be recognized that the acquisition of such complex equipment brings with it unique risks and challenges that need to be properly identified and managed using an appropriate procurement strategy.

6.64 **Recommendation.** National Defence should review and apply the lessons learned with these helicopter acquisitions to ensure that, for future major capital equipment acquisitions, the degree of modifications and/or development involved is fully reflected in approval documents—in the assessment of risk, project timelines, and costs—and that procurement strategies are tailored to the complexity of the equipment being acquired.

The Department's response. Agreed. National Defence continuously strives to capture the lessons learned in undertaking complex acquisitions and, in this context, will undertake a specific review of the projects encompassed by this report. In addition, a review of the associated policies, procedures, and processes will also be conducted and they will be revised as required.

6.65 Recommendation. Public Works and Government Services Canada should review and apply the lessons learned with these helicopter acquisitions to ensure that, for future major capital equipment acquisitions, the degree of modifications and/or development involved is fully reflected in approval documents and in the assessment of risk, and that procurement strategies and contracts are tailored to the complexity of the equipment being acquired.

The Department's response. Agreed. Public Works and Government Services Canada agrees to review the lessons learned with these helicopter acquisitions to ensure that, for future major capital acquisitions, the degree of modifications and/or development involved is fully reflected in approval documents and the assessment of risk, and that procurement strategies and contracts be tailored to the complexity of the equipment being acquired. The lessons learned will be completed by the end of March 2011.

Detailed life-cycle planning was begun late

6.66 As noted in paragraph 6.35 for the maritime helicopter project, full life-cycle costing and careful planning are needed to ensure that all elements required to provide a defence capability come together in a timely and predictable way and that adequate funds are available over the long term. This was particularly important in the case of the medium- to heavy-lift helicopter since National Defence is building a new capability from the ground up. We found it did not undertake the necessary detailed planning or costing of the medium- to heavy-lift helicopter project in a complete and timely way.

6.67 Early in the project, National Defence recognized in principle the elements needed, in addition to the helicopters, to provide full operating capability, such as personnel, training, infrastructure, operations, and long-term in-service support. In seeking Cabinet approval in principle for the acquisition in June 2006, National Defence had estimated the total long-term project costs to be $6.9 billion.

6.68 However, these total estimated costs were not presented to the Treasury Board. The costs that were presented were incomplete and underestimated, particularly at the preliminary project approval stage (Exhibit 6.6). Specifically, key items such as in-service support and personnel costs were not included. In addition, both the acquisition costs for the helicopter and infrastructure costs were initially underestimated. We observed improvements in the completeness of costing information presented to the Treasury Board for effective project approval in 2009.

Exhibit 6.6 Estimated cost information for the medium- to heavy-lift helicopters presented in the Treasury Board submissions

	Preliminary Project Approval June 2006	Effective Project Approval November 2009
	(In millions of Canadian dollars)*	
Capital costs		
Medium- to heavy-lift helicopters	1,025	1,245
Initial set-up (includes engineering, provision for spares, training facilities)	457	496
Project management	48	122
Contingency and escalation/inflation	430	232
Infrastructure	62	218
Total capital costs	**2,022**	**2,313**
Personnel, operating, and maintenance costs		
Contracted in-service support	not included	2,573
National Defence personnel	not included	not included
National Defence operating costs	not included	not included
Total personnel, operating, and maintenance costs	—	**2,573**
Total costs	**2,022**	**4,886**

* Figures have been rounded.

Source: Key approval documents—unaudited figures

6.69 In 2007, National Defence and PWGSC learned that the cost of each helicopter would be significantly higher than originally estimated. At this stage, detailed negotiations with Boeing were still under way. National Defence next realized that infrastructure costs would also be significantly higher than initially assumed. This triggered a series of meetings and discussions about what helicopter requirements were essential and how to narrow the project scope in an attempt to stay within its original cost estimate.

6.70 With respect to life-cycle planning for this helicopter, given the aggressive schedule and intent to award a contract in 2007 and have delivery of the first helicopter by 2010, we expected to see equally aggressive planning with respect to all of the elements required to provide the Chinook capability. It was not until June 2009 that the Program Management Board directed the development of detailed

plans for sourcing and training the personnel needed for the new squadron, infrastructure, and mitigating risks associated with the planned in-service support contract.

6.71 Details and costs concerning the provision of in-service support are still to be worked out and an amendment to the contract with Boeing is planned for 2013. Such provisions entail potentially significant financial and contracting risks. It is also planned that the in-service support provisions will be reviewed and amended at five-year intervals. According to National Defence and Boeing, this is intended to allow them to assess the costs on the basis of accumulated experience and data to the date of each review and to help reduce the risk.

6.72 In December 2006, the government decided to remove the provision for aircrew training from the scope of work planned with Boeing. Through a separate process and Treasury Board submission, a contract for this work was awarded to another firm. This is inconsistent with National Defence's principle of providing a single point of accountability with the original equipment manufacturer and the approach taken with respect to the Cyclone helicopter. The estimated costs for this service, together with 20 years of in-service support, is $320 million (including GST).

6.73 National Defence's full life-cycle planning for this project is still in progress and by the end of our audit had not been completed. Nor had the Department fully estimated all the life-cycle costs associated with this acquisition. Without such information, National Defence cannot adequately plan to have sufficient funds available for long-term operation and support of the helicopter. Moreover, without sufficient funds, National Defence may have to curtail planned training and operations.

6.74 **Recommendation.** National Defence should start estimating full life-cycle costs in the options analysis phase of its project management process and present these costs to decision makers at subsequent steps in the process as the estimates evolve. The basis of cost estimations should be included in approvals documents. National Defence should start full life-cycle planning for the preferred option in the definition phase of its project management process. Preparation of plans should be started at the time of preliminary project approval.

The Department's response. Agreed. National Defence follows well-established processes for progressively developing and refining full life-cycle cost estimates beginning with indicative cost estimates at the identification of the requirements, followed by more substantive cost

estimates confirmed through comprehensive analysis at the definition phase. National Defence continuously seeks to improve its cost estimates and, in response to this audit, will initiate a further review of the tools available and instructions in place to provide the best possible estimates to decision makers at each stage of the project approval process. Further, National Defence will ensure that relevant instructions and directives make clear the requirement to capture the basis for cost estimations in project files. Finally, while it is already a well-established requirement to initiate full life-cycle planning for the preferred option by the preliminary project approval stage, National Defence will review related instructions, tools, and compliance mechanisms to ensure that this is well-communicated and respected.

6.75 **Recommendation.** National Defence should undertake a review of lessons learned in the use of long-term in-service support contracts before amending the contract in 2013 with Boeing, in order to ensure that risks are appropriately identified and managed, costs are properly determined, and alternative service delivery options are considered.

The Department's response. Agreed. National Defence will continue to collect the lessons learned in the use of long-term in-service support contracts prior to amending the contract in 2013 with Boeing. This would include reviewing the existing in-service support contracts for the airlift capability project—tactical (ACP-T), maritime helicopter project and medium- to heavy-lift helicopter project, discussing the lessons learned with project managers from the three environments (Air, Land, and Sea), validating in-service support cost models, and communicating the findings to the proper in-service support policy owners for policy amendments. The aim is to ensure that risks are appropriately identified and managed, costs are properly determined, and alternatives are considered.

6.76 **Recommendation.** Public Works and Government Services Canada should undertake a review of lessons learned in the use of long-term in-service support contracts before amending the contract in 2013 with Boeing, in order to ensure that risks are appropriately identified and managed, costs are properly determined, and alternative service delivery options are considered.

The Department's response. Agreed. Public Works and Government Services Canada will review, in consultation with National Defence, the lessons learned in the use of long-term in-service support contracts before amending the contract in 2013 with Boeing, and will continue to have the risks appropriately identified in its approval documents. The Department will also request that National Defence confirm that

costs are being properly determined and that alternative delivery options have been considered. The lessons learned will be completed by the end of March 2011.

These lessons learned, which will be incorporated into the amendment for in-service support for the medium- to heavy-lift helicopter project expected in 2013, will complement those already learned through the procurement of the maritime helicopter project. These include managing the procurement to produce industrial and regional benefits and reduce contract administration costs, and encouraging the manufacturer to introduce support considerations into the design process.

The advance contract award notice did not comply with the contracting regulations and policy

6.77 The Treasury Board Contracting Policy permits the contracting authority to enter into a directed contract if one of four well-defined factors exists, as set out as an exception in the *Government Contracts Regulations*. One of these factors, and the one used as the basis for this directed contract, is that only one supplier is capable of performing the contract. In such cases, the Contracting Policy requires that the use of this exception be fully justified. Further, it also encourages whenever possible to advertise the proposed award through an advance contract award notice (ACAN). This is intended to inform potential suppliers that a directed contract is about to be awarded and to provide an opportunity to challenge that award. We examined the basis for the chosen procurement strategy and whether it was properly approved and carried out.

6.78 The acquisition of the Canadianized Chinook helicopters was a directed procurement. It is evident from the files that National Defence concluded very early in this acquisition process that the Chinook helicopter was the only one capable of meeting its needs. As early as the fall of 2005, National Defence was considering a sole-source procurement with Boeing. As previously noted, National Defence met with The Boeing Company soon after the 2005 Budget announcement, and it held several other meetings and exchanged technical and costing information with Boeing through 2005 to mid-2006. Other helicopter manufacturers were not accorded similar treatment. In addition, National Defence and PWGSC met with Boeing to plan next steps during the ACAN posting period, raising the potential for a real or perceived bias and lack of fairness on the part of the departments. It was not until another company responded to the ACAN (see paragraph 6.82) that communications with Boeing were suspended.

6.79 The ACAN posted by PWGSC indicated the intent of National Defence to solicit a bid and negotiate a contract with The Boeing Company on the basis that "research indicates that the Boeing CH-47 Chinook is the only aircraft that meets the high level mandatory capability requirements." This assessment was based on a market analysis prepared by National Defence. There was no justification for using the exception to the *Government Contracts Regulations* in the PWGSC files. Instead, PWGSC officials told us they used the market analysis prepared by National Defence as the justification. We found this justification to be incomplete: It included an assessment of selected helicopters against the four technical mandatory requirements but did not address the certification and delivery requirements. Nor did we find evidence that PWGSC evaluated Boeing's ability to meet all of the mandatory requirements before issuing the ACAN in 2006. In our opinion, while PWGSC approved the use of the ACAN, it did so on the basis of an inadequate justification. In 2007, well after the ACAN had been posted, PWGSC requested from National Defence the required written "sole-source" justification for its files, but this was never provided.

6.80 We found the ACAN assertion that Boeing could meet the certification and delivery requirements unrealistic. The ACAN indicated the intent to award a contract to Boeing by July 2007 and to accept delivery of the first helicopter 36 months later; that is, in 2010. This assertion could only have been met by purchasing a basic in-production Chinook F model. But National Defence did not intend to purchase an existing aircraft. On the contrary, at the time the ACAN was issued, negotiations with Boeing were still under way and National Defence was still articulating its needs and technical specifications. We found no evidence that PWGSC evaluated Boeing's ability to deliver the first Canadianized helicopter by 36 months from the anticipated contract award date. Later, a review by PWGSC of Boeing's response to the request for proposal issued in March 2008 confirmed that Boeing was unable to meet some of the requirements. In our opinion, it is evident that National Defence and PWGSC were unprepared to solicit a bid and negotiate and award a contract within one year as anticipated in the ACAN posting.

6.81 Based on the Treasury Board Contracting Policy and the related Guide for Managers—Best Practices for Using Advance Contract Award Notices, to be considered as fair, open, and transparent, an ACAN must provide sufficient information to allow other suppliers to determine if they possess the capabilities required to satisfy the requirement and should provide a good overview of the work to be contracted. PWGSC's

Supply Manual requires that relevant information, such as a statement of work, technical requirements, and evaluation criteria, be included in a bid solicitation (which by definition includes an ACAN). In our opinion, this was not the case: The ACAN included only the seven high-level mandatory requirements from the statement of operational requirements but none of the rated ones. In addition, while the ACAN also called for Boeing to provide 20 years of in-service support, no details were provided about what this was expected to include.

6.82 Moreover, one company submitted a response to the ACAN and provided a statement of capabilities for its helicopter. Its submission was formally evaluated by PWGSC and National Defence against the seven high-level mandatory requirements and a series of related criteria developed for purposes of the evaluation. Criteria against which potential suppliers are to be assessed must be available at the time the ACAN is posted. However, in this case, the criteria were developed during the ACAN posting period in reaction to the company's submission and, consequently, were not available for review by potential bidders when the ACAN was first posted, as is required by the Contracting Policy. The company's submission was found to be non-compliant, in part on the basis that the documentation provided by the company did not clearly show how it satisfied the criteria. The ACAN itself did not indicate the type of documentation expected. There is no evidence that Boeing was evaluated in a similar manner using the same criteria and documentation requirements, as required by the Contracting Policy and Guide for Managers.

6.83 Overall, in our opinion, the manner in which PWGSC used the 2006 ACAN did not comply with the letter or intent of the applicable regulations and policies and, consequently, the contract award process was not fair, open, and transparent. In addition, we believe a second ACAN should have been issued in 2009 and should have included the final helicopter requirements and specifications, the revised delivery and certification schedule, an indication of willingness to pay one-time engineering development costs, and other significant changes made to the project scope. These represent a significant difference from the information included in the 2006 ACAN. While this may not have affected the outcome, this would have enhanced fairness, openness, and transparency.

6.84 PWGSC believes that the process was fair, open, and transparent because the ACAN gave potential suppliers the opportunity to challenge the assertion that only one supplier could do the work.

Management oversight and approval by senior boards were missing at key decision points in the project

6.85 In approving large capital acquisitions, National Defence is expected to follow its Project Approval Guide. We observed a lack of compliance with the Project Approval Guide and the Treasury Board's Project Approval Policy, specifically noting the absence of timely meetings, challenge, and approvals by senior boards at key decision points in the process of acquiring the Canadianized Chinook helicopters.

6.86 At the identification phase of this acquisition, the capability deficiency document was reviewed by the Senior Review Board prior to its approval in July 2005. However, the Joint Capability Requirements Board, responsible for directing the department's capability-based planning process and for approving strategic capital projects, did not review or approve it, as required by National Defence's Project Approval Guide.

6.87 Internal approval documents required at the preliminary project and revised preliminary project decision points were not finalized or reviewed by the Senior Review Board or Program Management Board. Moreover, neither board met to challenge, discuss, and approve the information contained in the Treasury Board preliminary project approval submission before the Department submitted it. The Program Management Board met afterwards in March 2007 to approve the submission retroactively. The Senior Review Board did meet to discuss a draft revised preliminary project submission, but there is no record of decision indicating its approval. The Program Management Board did not meet to discuss nor did it approve this submission. These gaps in oversight are important because significant changes to the cost, scope, and schedule of the project were made during this period and decided without the senior boards' oversight and approval. For the 2009 effective project approval, both the Senior Review Board and Program Management Board met to discuss the planned Treasury Board submission, but there is no final record of their decision or endorsement.

6.88 As the project moved through the definition phase between June 2006 and June 2009, the Senior Review Board did not meet to monitor the project's progress. This is significant because National Defence committed to the Treasury Board in its preliminary project approval submission that this board would be convened annually to oversee the proper conduct of the project.

6.89 We also found no record of the Senior Review Board's approval of other key documents such as the project charter, statement of operational requirements, or any project profile and risk assessment. The information contained in these documents later became part of the documents submitted for project approvals within National Defence and the Treasury Board submissions.

6.90 National Defence officials have informed us that while these boards and committees did not always meet as required, senior personnel were involved, as required, in all aspects of the management of this project. National Defence acknowledges that deviations from the Project Approval Guide and the decisions taken outside of the normal process were not well documented.

6.91 We observed that for both the maritime helicopter and medium- to heavy-lift helicopter projects, key requirements set out in the National Defence Project Approval Guide were not respected. The Guide is important because it provides a framework for managerial oversight and decision making and ensures that sound project management principles are applied and Treasury Board policies are followed.

6.92 Recommendation. National Defence should ensure that key boards fulfill their roles in a timely manner. National Defence should clarify the process and documentation required to deviate from the Project Approval Guide and the Treasury Board's Project Approval Policy where it deems that special arrangements are necessary for complex and sensitive projects. All decisions taken during the course of an acquisition should be fully documented.

The Department's response. Agreed. The Terms of Reference of each of the key governance boards in the Department are being refined and finalized. National Defence plans to have these terms of reference approved and in place by January 2011 with each board being chaired by the accountable decision maker (Assistant Deputy Minister or Deputy Minister Level).

As part of the planned update of the Project Approval Guide, the guidance will be adjusted to reflect the flexibility that is required for the approval of complex and sensitive projects. Specifically, in the event that it is not possible to formally convene a senior review board (such as the Senior Review Board, Program Management Board, or similar bodies), project files will be required to obtain the same authorization, approvals, and signatures even if they are pursued secretarially and/or by meeting individually with the applicable board members.

Challenge Function of the Treasury Board of Canada Secretariat

We could not reach a conclusion about analysis and challenge provided by the Secretariat

6.93 According to the Treasury Board's document A Guide to Preparing Treasury Board Submissions, the Treasury Board of Canada Secretariat provides a challenge function to ensure that submissions have been thoroughly analyzed in light of considerations such as authorities, affordability, effectiveness, program delivery, protection of public funds, performance measurement, costs and funding, and risks.

6.94 We set out to examine the analysis and challenge carried out by the Secretariat when project and contract proposals were submitted for Treasury Board approval. We requested documentation from the Secretariat that would demonstrate the challenge it conducted in the two National Defence helicopter projects audited.

6.95 However, we were unable to conclude on this aspect of our audit. For six of the eight Treasury Board submissions requested, we received almost no documentation. For the other two, we received over 270 emails that were heavily redacted on the basis of Cabinet confidences. Moreover, even if we had received the emails unredacted, Secretariat officials informed us that much of their challenge function is undertaken verbally, and thus, there would have been no documented evidence.

6.96 Our access to Cabinet confidences created before 2006 is governed by a 1985 order-in-council that permits access only to certain types of Cabinet confidences. In 2006, a new order-in-council was intended to clarify our access to Cabinet confidences demonstrating, among other things, the challenge function carried out by the Secretariat after February 2006. Near the end of the audit work, the Office of the Auditor General of Canada (OAG), the Secretariat, and the Privy Council Office jointly developed new guidance to provide clarity on the OAG's access to analysis and other confidential information. Despite the new agreement regarding access, too much time passed to allow new information to be considered in the course of this audit. We were therefore unable to conclude on the exercise of that challenge function before or after 2006.

Conclusion

6.97 Regarding project management, National Defence did not fully comply with the key provisions of the Treasury Board Project Management Policy, Project Approval Policy, and Policy on the Management of Major Crown Projects or with the Department's Project Approval Guide in managing the acquisition of the two types of military helicopters selected for our audit. Specifically, we identified several gaps in the completeness of information presented to decision makers as well as approvals and oversight by senior boards at key decision points.

6.98 Regarding contract management, with respect to the maritime helicopter project, we conclude that Public Works and Government Services Canada (PWGSC) and National Defence generally complied with the provisions of the *Government Contracts Regulations* and the Treasury Board's Contracting Policy. With respect to the medium- to heavy-lift helicopter project, we conclude that the manner in which PWGSC used the advance contract award notice did not comply with the letter or intent of the applicable regulations and policies and, consequently, the contract award process was not fair, open, and transparent.

6.99 We were unable to conclude whether the Treasury Board of Canada Secretariat exercised its challenge function when it received the project and contract proposals for the two helicopter projects audited.

About the Audit

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by The Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

Objectives

The overall objective of the audit was to determine whether National Defence and Public Works and Government Services Canada (PWGSC) managed the acquisition of selected military helicopters in compliance with key provisions of government contracting and major capital project legislation, regulations, policies, and guidelines and to determine whether the Treasury Board of Canada Secretariat performed its related challenge function.

The audit objectives for the two lines of enquiry were as follows:

- To determine whether National Defence managed the acquisition of selected military helicopters in compliance with key provisions of the Treasury Board Project Management Policy, Policy on the Management of Major Crown Projects, and Project Approval Policy; and
- To determine whether PWGSC and National Defence awarded and administered contracts for the acquisition of selected military helicopters in compliance with key provisions of the *Financial Administration Act*, *Government Contracts Regulations*, and the Treasury Board Contracting Policy.

Scope and approach

Our audit focused on the acquisitions of the maritime helicopters and the medium- to heavy-lift helicopters, undertaken by National Defence for military operations.

The audit examined how National Defence managed the projects to ensure that the acquisitions met government policies related to project management and that the helicopters it was purchasing would address capability needs in a cost-efficient manner. Specifically, the audit examined whether National Defence has filled an identified capability gap with the new helicopters in meeting operational requirements. The audit also examined how the Department managed the project schedule, risks, and costs. We also examined whether adequate documentation existed to support key decisions, including whether total costs were adequately estimated and validated. Finally, we examined whether, at key project decision points, approval was made by the appropriate individual in compliance with authorities.

The audit also examined whether National Defence and Public Works and Government Services Canada (PWGSC) carried out the contracting for the acquisition and in-service support in accordance with contracting authorities. The audit assessed whether PWGSC awarded contracts in a fair, open, and transparent manner in accordance with contracting authorities.

The audit examined documents and correspondence contained in National Defence project files and PWGSC procurement files. PWGSC and National Defence officials involved in the selected projects were also interviewed.

It should be noted that our conclusions about management practices and actions apply only to those of public servants in the federal government. The rules and regulations we refer to apply to public servants; they do not apply to contractors. We did not audit the records of the private sector contractors. Consequently, our conclusions cannot and do not pertain to the contractors' practices or to their performance.

The audit did not consider industrial and regional benefits of the projects and the associated role of Industry Canada in the procurement process.

In 2008, the government approved over $400 million to purchase and support six used Chinook D helicopters for use in Afghanistan from the United States Army through a foreign military sales contract. This acquisition was not examined in the course of this audit.

Criteria

To determine whether National Defence and Public Works and Government Services Canada managed the acquisition of the maritime and the medium- to heavy-lift helicopters in compliance with selected key provisions of applicable regulations and policies, we used the following criteria:

Criteria	Sources
National Defence complies with key provisions of Treasury Board and departmental project management policies for the following phases of the military helicopter acquisition process: • problem identification • option analysis • definition • implementation The Treasury Board of Canada Secretariat provides a challenge function to ensure that the submissions have been adequately analyzed and reviewed by its managers.	• Project Management Policy, Treasury Board, 1994 • Project Approval Policy, Treasury Board, 1994 and 2005 • Policy on the Management of Major Crown Projects, Treasury Board, 1994 • Project Approval Guide, National Defence, 1998 • Procurement Administration Manual, National Defence, 2007
Public Works and Government Services Canada (PWGSC) awards contracts for the acquisition of selected military helicopters in compliance with key provisions of appropriate legislation, regulations, policies, and guidelines for the following phases of the contract award process: • procurement strategy • solicitation • evaluation/negotiation • contract approval National Defence and PWGSC administer the selected military helicopter contracts in compliance with key provisions of appropriate legislation, regulations, policies, and guidelines. The Treasury Board of Canada Secretariat provides a challenge function to ensure that the submissions have been adequately analyzed and reviewed by its managers.	• *Financial Administration Act*, sections 32, 33, and 34 • *Government Contracts Regulations* • Contracting Policy, Treasury Board, 2008 • Supply Manual, Public Works and Government Services Canada, 1994 and 2005 • Procurement Administration Manual, National Defence, 2007 • Guide for Managers—Best Practices for using ACAN, Treasury Board, January 2004

Management reviewed and accepted the suitability of the criteria used in the audit.

Period covered by the audit

Although the maritime helicopter project began in 1995, the activities we audited occurred between 1999 and 31 March 2010. The audit of the medium- to heavy-lift helicopter project covered activities between January 2005 and 31 March 2010.

Audit work for this chapter was substantially completed on 30 April 2010.

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Appendix List of recommendations

The following is a list of recommendations found in Chapter 6. The number in front of the recommendation indicates the paragraph where it appears in the chapter. The numbers in parentheses indicate the paragraphs where the topic is discussed.

Recommendation	Response
6.64 National Defence should review and apply the lessons learned with these helicopter acquisitions to ensure that, for future major capital equipment acquisitions, the degree of modifications and/or development involved is fully reflected in approval documents—in the assessment of risk, project timelines, and costs—and that procurement strategies are tailored to the complexity of the equipment being acquired. **(6.18–6.33 and 6.49–6.63)**	National Defence continuously strives to capture the lessons learned in undertaking complex acquisitions and, in this context, will undertake a specific review of the projects encompassed by this report. In addition, a review of the associated policies, procedures, and processes will also be conducted and they will be revised as required.
6.65 Public Works and Government Services Canada should review and apply the lessons learned with these helicopter acquisitions to ensure that, for future major capital equipment acquisitions, the degree of modifications and/or development involved is fully reflected in approval documents and in the assessment of risk, and that procurement strategies and contracts are tailored to the complexity of the equipment being acquired. **(6.18–6.33 and 6.49–6.63)**	Agreed. Public Works and Government Services Canada agrees to review the lessons learned with these helicopter acquisitions to ensure that, for future major capital acquisitions, the degree of modifications and/or development involved is fully reflected in approval documents and the assessment of risk, and that procurement strategies and contracts be tailored to the complexity of the equipment being acquired. The lessons learned will be completed by the end of March 2011.

Recommendation	Response
6.74 National Defence should start estimating full life-cycle costs in the options analysis phase of its project management process and present these costs to decision makers at subsequent steps in the process as the estimates evolve. The basis of cost estimations should be included in approvals documents. National Defence should start full life-cycle planning for the preferred option in the definition phase of its project management process. Preparation of plans should be started at the time of preliminary project approval. **(6.35–6.42 and 6.66–6.73)**	Agreed. National Defence follows well-established processes for progressively developing and refining full life-cycle cost estimates beginning with indicative cost estimates at the identification of the requirements, followed by more substantive cost estimates confirmed through comprehensive analysis at the definition phase. National Defence continuously seeks to improve its cost estimates and, in response to this audit, will initiate a further review of the tools available and instructions in place to provide the best possible estimates to decision makers at each stage of the project approval process. Further, National Defence will ensure that relevant instructions and directives make clear the requirement to capture the basis for cost estimations in project files. Finally, while it is already a well-established requirement to initiate full life-cycle planning for the preferred option by the preliminary project approval stage, National Defence will review related instructions, tools, and compliance mechanisms to ensure that this is well-communicated and respected.
6.75 National Defence should undertake a review of lessons learned in the use of long-term in-service support contracts before amending the contract in 2013 with Boeing, in order to ensure that risks are appropriately identified and managed, costs are properly determined, and alternative service delivery options are considered. **(6.35–6.42 and 6.66–6.73)**	Agreed. National Defence will continue to collect the lessons learned in the use of long-term in-service support contracts prior to amending the contract in 2013 with Boeing. This would include reviewing the existing in-service support contracts for the airlift capability project—tactical (ACP-T), maritime helicopter project and medium- to heavy-lift helicopter project, discussing the lessons learned with project managers from the three environments (Air, Land, and Sea), validating in-service support cost models, and communicating the findings to the proper in-service support policy owners for policy amendments. The aim is to ensure that risks are appropriately identified and managed, costs are properly determined, and alternatives are considered.

Recommendation	Response
6.76 Public Works and Government Services Canada should undertake a review of lessons learned in the use of long-term in-service support contracts before amending the contract in 2013 with Boeing, in order to ensure that risks are appropriately identified and managed, costs are properly determined, and alternative service delivery options are considered. **(6.35–6.42 and 6.66–6.73)**	Public Works and Government Services Canada will review, in consultation with National Defence, the lessons learned in the use of long-term in-service support contracts before amending the contract in 2013 with Boeing, and will continue to have the risks appropriately identified in its approval documents. The Department will also request that National Defence confirm that costs are being properly determined and that alternative delivery options have been considered. The lessons learned will be completed by the end of March 2011. These lessons learned, which will be incorporated into the amendment for in-service support for the medium- to heavy-lift helicopter project expected in 2013, will complement those already learned through the procurement of the maritime helicopter project. These include managing the procurement to produce industrial and regional benefits and reduce contract administration costs, and encouraging the manufacturer to introduce support considerations into the design process.
6.92 National Defence should ensure that key boards fulfill their roles in a timely manner. National Defence should clarify the process and documentation required to deviate from the Project Approval Guide and the Treasury Board's Project Approval Policy where it deems that special arrangements are necessary for complex and sensitive projects. All decisions taken during the course of an acquisition should be fully documented. **(6.43–6.46 and 6.85–6.91)**	Agreed. The Terms of Reference of each of the key governance boards in the Department are being refined and finalized. National Defence plans to have these terms of reference approved and in place by January 2011 with each board being chaired by the accountable decision maker (Assistant Deputy Minister or Deputy Minister Level). As part of the planned update of the Project Approval Guide, the guidance will be adjusted to reflect the flexibility that is required for the approval of complex and sensitive projects. Specifically, in the event that it is not possible to formally convene a senior review board (such as the Senior Review Board, Program Management Board, or similar bodies), project files will be required to obtain the same authorization, approvals, and signatures even if they are pursued secretarially and/or by meeting individually with the applicable board members.

Report of the Auditor General of Canada to the House of Commons—Fall 2010

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2010



FALL

Report of the
Auditor General of Canada
to the House of Commons

Chapter 7
Registered Charities—Canada Revenue Agency

Office of the Auditor General of Canada



2010



Report of the

Auditor General of Canada

to the House of Commons

FALL

Chapter 7

Registered Charities—Canada Revenue Agency

Office of the Auditor General of Canada

The Fall 2010 Report of the Auditor General of Canada comprises Matters of Special Importance, Main Points—Chapters 1 to 9, Appendices, and nine chapters. The main table of contents for the Report is found at the end of this publication.

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Chapter

7

Registered Charities—Canada Revenue Agency

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Registered Charities—Canada Revenue Agency

Main Points

What we examined

There are more than 85,000 registered charities in Canada. They are exempt from paying tax on their income, and the federal government allows taxpayers to claim a tax deduction or a tax credit for charitable donations to reduce the income tax that they pay. For 2009, the estimated cost to the federal government of providing tax relief to individuals for charitable donations was almost $2.4 billion.

The Canada Revenue Agency administers the *Income Tax Act*, including the provisions that relate to registered charities. To fulfil its role with respect to registered charities, the Agency defines its responsibilities as processing applications for registered charity status, carrying out audit and compliance activities, offering advice and guidance on complying with requirements of the Act, and providing general information to the public.

We examined how the Agency encourages compliance with the provisions of the *Income Tax Act* that relate to registered charities. We also looked at how the Agency deals with tax shelter gifting arrangements. These arrangements typically promise taxpayers (or "participants") that they can buy property, donate it, and receive a donation tax credit that is worth more than the amount they originally spent to purchase the donated property. Promoters of tax shelters are required to obtain an identification number from the Agency before they can sell, issue, or accept consideration from participants.

Audit work for this chapter was substantially completed on 8 June 2010.

Why it's important

To many Canadians, charities play an important role in society. They provide services that people might otherwise expect the government to provide. Canadians can volunteer for causes important to them, or make donations to those charities that they want to support.

The Agency's role is to ensure that charities comply with the measures in the *Income Tax Act*, so that their activities will achieve the charitable purposes for which they have been created.

As part of its role in protecting taxpayers by preventing abuses, the Agency has announced that it is reviewing all tax shelter-related gifting arrangements. It plans to audit every participating charity, promoter, and participant and has issued a number of news releases warning taxpayers about the arrangements. Tens of thousands of taxpayers have invested in these arrangements. Although very few registered charities are involved with tax shelter gifting arrangements, their actions could impact the whole charitable sector and cause some donors to stop making donations to those charities that are not involved in abusive tax shelters.

What we found

- The Agency's process for registering charities is thorough. The controls in place are adequate to monitor and manage the process for approving an organization's application for registered charity status. This process is important because it may be the most in-depth involvement the Agency has with a charity during its life cycle.
- More than 33,000 charities did not file their annual information returns on time in 2008. The Agency posts certain information from these returns on its public website. Donors can visit the Agency's website to check that a charity is registered and see select operating and board member information. Agency policy for dealing with charities that file their annual returns late is to issue reminder letters and de-register the charity after 10 months. Between 2007 and 2009, over 3,000 charities had their registration revoked for failure to file their returns. Most charities did file their returns once they received reminders.
- The Agency carries out random and risk-based audits to verify that registered charities remain in compliance with the *Income Tax Act*. In cases of non-compliance, the Agency has a range of tools and sanctions it can apply, ranging from education letters and negotiated agreements to intermediate and serious sanctions. However, although it has guidelines and references to sanctions in its audit manuals, it lacks sufficiently detailed internal guidance. During the period under audit, it continued to use mostly education letters, compliance agreements, and revocations; two charities were assessed intermediate sanctions.
- The Agency's communication to charities and donors is good, with information accessible through several channels, such as on the Agency website; by telephone, webcasts, and outreach programs; and on paper. For example, users can use the Internet, mail, or telephone to check whether a charity is currently registered, under suspension from issuing tax receipts, or has had its charitable status

revoked. The Agency also has processes to ensure that the information it adds to its website is accurate and feedback mechanisms to verify that users' information needs are being met.

- The Agency has expressed concerns with some tax shelter gifting arrangements and has issued general warnings about them. The number of active tax shelter gifting arrangements is declining, but people continue to invest in them, a total of 172,300 by 31 December 2009. The Agency has audited many of them and by 31 March 2009, it had reassessed the amount of charitable donations claimed by over 69,000 participants who had invested in these arrangements.

The Agency has responded. The Agency agrees with all of our recommendations. Its detailed responses follow the recommendations throughout the chapter.

Introduction

7.1 Canada has over 85,000 registered charities that provide assistance related to the relief of poverty, the advancement of education or religion, or other activities that are beneficial to communities. These charities rely on millions of volunteers, as well as paid staff in some organizations, to carry out their activities.

7.2 The federal government supports registered charities by allowing tax deductions or credits for charitable donations, which will reduce donors' income taxes. In addition, registered charities do not pay income tax. The cost to the federal government of providing tax relief to individuals for charitable donations was estimated to be almost $2.4 billion for 2009. The Department of Finance Canada estimates the impact of this provision annually (Exhibit 7.1).

Exhibit 7.1 The estimated cost of providing tax relief to individuals for charitable donations exceeds $2 billion each year

Year	Cost ($millions)
2006	2,480
2007	2,495
2008	2,380
2009	2,380

Note: The figures were not audited by the Office of the Auditor General.

Source: Tax Expenditures and Evaluations 2009, Department of Finance Canada

Administration of the provisions of the *Income Tax Act* that relate to registered charities

7.3 The Canada Revenue Agency is responsible for administering the provisions of the *Income Tax Act* that relate to registered charities. To fulfill this role, the Agency lists the following among its responsibilities, carried out primarily by its Charities Directorate:

- processing applications for registration,
- offering technical advice on operating a charity,
- handling audit and compliance activities, and
- providing general information to the public.

7.4 The Agency does not monitor provincial responsibilities, such as the governance and management of charities, and the role of the board of directors.

7.5 The Agency has approximately 41,000 employees. Of those employees, 270 are in the Charities Directorate; another 40 in seven Tax Services Offices are responsible for audits of registered charities that are located across Canada. In 2009, the budget for the Charities Directorate was $23 million, of the Agency's total budget of $4.3 billion.

Regulatory reform

7.6 In 2000, the government formed the Joint Regulatory Table, a working group comprising voluntary sector members and federal officials. It was convened under the Voluntary Sector Initiative to study and make recommendations for improving the voluntary sector's legislative and regulatory environment.

7.7 The final report, *Strengthening Canada's Charitable Sector: Regulatory Reform* (2003), examined the federal regulation of charities and looked at options for change in the following four key areas:

- accessibility and transparency of the federal regulator, including making information it holds about charities available to the public;
- better access to appeals for organizations that disagree with decisions made by the regulator;
- compliance reforms, such as the possibility of introducing new sanctions to ensure charities meet their legal obligations; and
- possible institutional reform models for the federal regulator (for example, considering whether a charity commission should be the federal regulator of charities or whether a new voluntary sector agency should be created to work with the Agency).

7.8 In the 2004 federal budget, the government responded to the majority of the Joint Regulatory Table's 75 recommendations by making a number of amendments to the *Income Tax Act* in the following areas:

- a new compliance regime,
- a more accessible appeals regime,
- improved transparency, and
- more accessible information.

Focus of the audit

7.9 The objective of the audit was to determine whether the Canada Revenue Agency had processes designed to increase compliance with the charities provisions of the *Income Tax Act*. The Agency has stated that it is committed to increasing compliance in areas of tax regulation by providing strong taxpayer assistance.

7.10 We looked at how the Agency administers the provisions of the *Income Tax Act* that relate to registered charities and examined the processes the Agency has to deal with certain tax shelter gifting arrangements that use registered charities. The audit also looked at how the Agency communicates with charities and donors.

7.11 We examined the processes in place for the 2006–07, 2007–08, and 2008–09 fiscal years. In addition, we tested the controls for processing applications for registration as a charity, reviewed the Agency's risk assessment and audit planning, and examined how the Agency considered the results of those activities. We also analyzed the application of penalties according to the *Income Tax Act*. For tax shelter gifting arrangements, we evaluated how the Agency communicated with potential participants, and whether it had a process for determining the tax shelters' compliance with the *Income Tax Act*.

7.12 More details on the audit objectives, scope, approach, and criteria are in **About the Audit** at the end of this chapter.

Observations and Recommendations

Registered charities

7.13 The *Income Tax Act* defines a registered charity as a charitable organization, or private or public foundation that meets certain criteria for registration. To be a charitable organization, an organization must devote all resources to charitable activities, which it carries out itself. A charitable foundation (public or private) must be constituted and must operate exclusively for charitable purposes. As the Act does not define the terms "charitable activities" or "charitable purposes," the Canada Revenue Agency relies on the common law definition, which describes a charity as an organization established for any of the following four purposes:

- the relief of poverty,
- the advancement of education,

- the advancement of religion, and
- other purposes beneficial to the community in a way the law regards as "charitable."

7.14 Examples of organizations with charitable purposes include soup kitchens; universities; organizations that provide scholarships, bursaries, and prizes for scholastic achievement; religious bodies (when their activities serve religious purposes for the public good); and organizations that provide counselling services for people in distress.

7.15 Although other organizations operate to benefit a community in a popular sense, they do not meet the definition of a registered charity in the legal sense. For example, organizations such as social clubs, trade unions, and condominium corporations, although not established to earn a profit, are not charitable and cannot be registered as a charity. They may be exempt from paying income tax but are not able to issue receipts for donations.

The registration process is thorough

7.16 In order to approve an application for registration, the Canada Revenue Agency needs to have a process designed to ensure that the organization applying for registration meets the *Income Tax Act* requirements. If an organization does not qualify, it should be informed of the reason and told how it can appeal the decision. An organization cannot issue donation receipts until it has received registered charity status.

7.17 When an organization applies to be a registered charity, it fills out an application form and submits it to the Agency. The application includes information about the organization's charitable purposes, activities, and operating budget, as well as information about its officials. The organization must also submit governing documents, such as articles of incorporation. These documents must include a description of the activities that the organization will undertake to achieve the charitable purposes for which it has been established.

7.18 When the Agency receives an application for registration, it examines the organization to ensure that its operations meet the legislative requirements of the *Income Tax Act*. The registration process is important because this may be the most in-depth involvement that the Agency has with the registered charity during its life cycle. Future Agency involvement may consist only of reviewing the charity's annual information reporting package and posting it on the Agency website.

7.19 We reviewed applications for registered charity status in a random sample of 45 files from a three-year period that ended 31 March 2009, to determine whether the Agency had controls in place and that they were operating effectively to monitor and manage the process to approve an organization for registered charity status. Our sample included applications for registration and for re-registration, some but not all of which were approved as registered charities. We considered whether

- decisions were reviewed and approved according to stated Agency policies,
- service targets published in the Agency's Annual Report to Parliament were met, and
- the organizations that were turned down were notified of their right to appeal.

7.20 When we tested these controls, we looked for evidence such as whether the Agency employee reviewed the application, determined that the purposes and activities would be charitable, did research where necessary, and issued the appropriate report, and also whether decisions were reviewed as appropriate. We found that the Agency's controls were adequate and functioning as intended, and that decisions were reviewed and approved.

7.21 The Agency has new registration service targets, which it published in its Annual Report to Parliament for the 2008–09 fiscal year. The Agency committed to responding to 80 percent of simple applications in two months, and to 80 percent of regular applications in six months. However, it did not meet these new service targets for either the 2007–08 or 2008–09 fiscal year (Exhibit 7.2). In order to meet these service targets, the Agency informed us that for the following year (2009–10) it took steps to deal with staffing shortages and a high inventory of charity files that needed to be processed. As a result, management indicated that performance has improved.

Simple applications—Complete applications with charitable purposes and activities these applications meet all of the other requirements of the Income Tax Act and require no further detail.

Regular applications—Applications that require additional information from the applicant before the Canada Revenue Agency can determine whether or not the organization qualifies for charitable registration.

Exhibit 7.2 The Agency has not met its new registration service targets of 80 percent

	2006–07	2007–08	2008–09
Target for simple applications—80% response in 2 months	Not measured	42%	58%
Target for regular applications—80% response in 6 months	Not measured	53%	22%

Note: The figures were not audited by the Office of the Auditor General.

Source: Canada Revenue Agency Annual Report to Parliament, 2008–2009

Many registered charities file their annual information returns late

7.22 The *Income Tax Act* identifies many administrative activities that the registered charity needs to complete, such as

- preparing donation receipts for the correct amount in a prescribed fashion;
- maintaining books and records; and
- filing an annual Registered Charity Information Return (T3010), along with attachments and financial statements, on time.

7.23 The T3010 reporting package (return) is the only information the Agency requires a charity to submit annually in order to maintain its registered status. Registered charities must file the return within six months of the end of their fiscal period (year end). The Agency also asks the charity to inform it about changes to its mode of operation or legal structure. The Agency ensures that the returns are complete and watches for potential issues that would indicate the need for an audit. Equally important, donors can access certain information from the return that the Agency posts on its public website. The Agency does not post annual financial statements, but the public can request copies from the Agency.

7.24 The report of the Joint Regulatory Table stated that the best approach to deal with charities that file their annual returns late would be to list the non-filing charities on the Agency's website. The listing would indicate that the Agency would deregister the charity unless it filed the return by a certain date. This would lead to pressure from the local community to remind the charity of its legal obligation. The actual changes introduced to the *Income Tax Act* in 2004 to respond to these recommendations allow the Agency to publish the name of the late-filing charity only after it has charged a late-filing penalty of $500.

7.25 The Agency's policy, however, is to charge the late-filing penalty only when it has revoked registration and the charity has reapplied for registration. As a result, only those organizations that have had their status revoked for failure to file are listed on the Agency's website, since the law allows a revoked charity's name to be disclosed. Consequently, it is not always apparent to the public that a charity's return is late and that information about a charity on the website may not be current.

7.26 The Agency's follow-up process for outstanding returns is to issue reminders and then revoke registration during the tenth month after the charity's year end. Data that the Agency provided indicates a

slight increase in returns being filed on time—from 57 percent in 2007 to 59 percent in 2008. However, this still means that more than 33,000 (41 percent) of registered charities did not file their 2008 returns on time. Although most charities did file their returns once they received reminders, between 2007 and 2009 over 3,000 charities had their registration revoked for failure to file their returns.

7.27 **Recommendation.** The Canada Revenue Agency should evaluate whether its current process for dealing with annual information returns meets its objective of increasing compliance and receiving returns on time.

The Agency's response. Agreed. An evaluation of the current process for dealing with late-filed returns will be completed by September 2011.

Audits of registered charities ensure continued eligibility

7.28 To ensure that registered charities continue to comply with the *Income Tax Act*, the Agency has an audit and review process. It may select organizations for audit based on a review of the annual information returns, public complaints, and follow-up on past **compliance agreements**.

Compliance agreement—A formal document signed by both the Canada Revenue Agency and the charity to correct previously noted problems.

7.29 In its annual audit plan for registered charities, the Agency states that the plan is "designed to evaluate the level of compliance and the effectiveness of the Agency's risk assessment system in identifying high-risk files." The audit plan also indicates the Agency's intent to audit one percent of registered charities every year. This includes files selected for audit based on an assessment of risk factors (targeted audits), as well as 150 random audits, which are discussed in the following section. The Agency initiates targeted audits when it identifies a potential high-risk issue.

7.30 Specialists at seven Tax Services Offices conduct detailed audits of files selected for review. In an audit, the Agency may look at records of donor receipts and amounts spent on charitable programs and administration to ensure that activities are still charitable. The Charities Directorate at Agency headquarters conducts smaller "desk audits," consisting of a telephone call or a letter requesting information.

7.31 We reviewed the Agency's results of its targeted and random audits. Between April 2006 and March 2009, the results of the almost 2,500 audits were as follows:

- 69 percent were clean or resulted in education letters (letters that explain the rules to a charity) being issued (least serious);

- 21 percent resulted in a compliance agreement; and
- 7 percent resulted in revocations (most serious).

The balance of three percent related to other types of audits, such as pre-registration audits.

7.32 These results indicate that the majority of the Agency's audits of registered charities did not find serious non-compliance.

Random audits may not produce sufficiently reliable measures of compliance

7.33 In its annual Report on Plans and Priorities, the Agency committed to reporting a compliance rate for charities, beginning in its 2009–10 Performance Report.

7.34 With statistical sampling methods, it is critical to develop and execute a plan within pre-determined parameters, such as time period covered and file selection, and to have procedures in place to deal with missing or miscoded information. Although the Agency's overall audit plan indicated its intent to conduct 150 random audits, we found no details indicating purpose, sampling methodology, or time frames for these random audits. As well, although the overall plan indicated that the Agency will conduct these audits each year, we found that the number of organizations selected for audit varied, with no justification for the number selected each year.

7.35 The Agency completed most random audits within the year planned, although a number of them were still in progress in the next fiscal year. For example, for the 2008–09 fiscal year, 158 files were selected and 20 of them were still incomplete by the 2009–10 fiscal year.

7.36 Without the implementation and completion of a random sampling plan, the Agency may not have statistically reliable findings on which to measure an overall compliance rate for registered charities.

7.37 **Recommendation.** The Canada Revenue Agency should develop and execute a random sampling plan to meet its commitment to report a compliance rate for registered charities.

The Agency's response. Agreed. The Agency will develop a revised random sampling plan for implementation in the 2011–12 fiscal year.

The Agency does not have sufficiently detailed internal guidance to apply sanctions

7.38 Before regulatory reform, revoking charitable status was the primary sanction available to the Agency. The Joint Regulatory Table considered this to be too severe to be effective and recommended a sanctions regime that would encourage compliance with the law and have a range of penalties. The focus was to remediate the charities and work with them to develop solutions to problems as they arise.

7.39 This led to the addition of intermediate sanctions to the *Income Tax Act* in 2004, including an increased penalty for repeat assessment of certain issues. Exhibit 7.3 presents an overview of tools and sanctions and the Agency's description of them, listed from least to most severe.

7.40 The Agency takes a continuum approach to encouraging registered charities to comply with the *Income Tax Act*. The primary focus is on education, and the secondary focus is on monitoring and auditing the charities. If an audit finds a registered charity to be non-compliant, the Agency encourages the organization to improve by negotiating a compliance agreement that includes areas for improvement. Both the Agency and the charity sign the agreement, and the Agency follows up with another audit. If the charity does not respect the agreement, the Agency may apply intermediate sanctions. The ultimate sanction is for the charity to have its registered status revoked.

Exhibit 7.3 The Agency has a number of tools and sanctions to encourage charities' compliance

Tools and sanctions to obtain compliance	Description
Education	• Provide written advice through the Canada Revenue Agency website, publications, and education letters • Answer questions • Offer seminars
Compliance agreement	• Have discussions with the charity and sign a compliance agreement
Intermediate sanctions	• Impose financial penalties • Suspend the charity's status as a qualified donee, resulting in its inability to issue official donation receipts
Serious sanction	• Revoke the charity's registration resulting in its inability to issue receipts for donations and possibly becoming subject to paying income tax

Source: Canada Revenue Agency's website (www.cra-arc.gc.ca), Guidelines for Applying the New Sanctions and Consequences of Revocation

7.41 We examined whether the Agency had procedures and clear guidelines in place to determine which sanctions it should apply, and when, in order to ensure appropriate application of the *Income Tax Act*. Although the Agency has guidelines and references to sanctions in its audit manuals, which provide general descriptions, in our view, it does not have sufficiently detailed internal guidance for the application of these relatively new sanctions. Based on the existing guidance, the Tax Services Office carrying out the audit makes the decision to apply a sanction. The Director General of the Charities Directorate must approve intermediate and serious sanctions, but does not usually review cases where a sanction has not been applied.

7.42 During the period under audit, the Agency continued to use education letters, compliance agreements, and revocations as its most frequent tools to obtain compliance. There were 127 revocations for cause and two sanctions other than revocation in the three-year period of our audit.

7.43 Recommendation. The Canada Revenue Agency should evaluate the effectiveness of its use of various tools, such as sanctions and compliance agreements, to increase registered charities' compliance with the *Income Tax Act*. The Agency should also develop, document, and implement detailed internal guidance to clarify when and how sanctions should be applied.

The Agency's response. Agreed. The Agency is already evaluating the effectiveness of compliance agreements and will evaluate the effectiveness of its use of tools in the next two to three years.

The Agency has taken steps to develop internal guidance with respect to the application of sanctions and to strengthen the process for applying these sanctions. The Agency will continue to make improvements and will provide further guidance on the application of sanctions by March 2011.

The Agency's process for monitoring the appropriate disposition of a revoked charity's assets is informal

7.44 A registered charity may have its status revoked for a number of reasons:

- voluntary revocation, when it is winding up its operations;
- failure to file an information return; or

- revocation for cause, for example, for issuing a receipt for a gift or donation inappropriately, or for failing to keep books and records in Canada.

7.45 Between April 2006 and March 2009, approximately 5,850 charities had their status revoked, more than half due to returns not being filed. Voluntary revocations accounted for 46 percent, and revocations for cause were 2 percent of the total.

7.46 When the Minister issues a notice of intention to revoke the registration of a registered charity and revokes its status, the charity must transfer its net assets to an **eligible donee**, use the assets for charitable activities or programs, or remit those assets to the Crown within one year. The first two options are intended to encourage the use of the funds for charitable purposes, as opposed to requiring the charity to remit the funds to the Crown, since they were originally donated to the charitable organization.

Eligible donee—A registered charity of which more than 50 percent of the members of its board of directors or trustees deal at arm's length with each member of the board of directors or trustees of the charity that has been sanctioned or revoked. It must also not be under suspension and must have filed all its information returns, among other criteria.

7.47 The Agency is responsible for ensuring that the assets are disposed of according to the provisions of the *Income Tax Act*. It requires a tax return to identify the net assets and to indicate whether any assets were transferred to eligible donees or paid to the Crown. We found that employees use their personal email calendars to create lists of revoked charities to follow up on in one year to confirm that they have transferred assets as required. As these lists are in an individual employee's calendar, they may not be accessible by others. There is no centralized reporting or monitoring of Agency follow-up on revoked charities. This process lacks rigour and could result in inadequate follow-up.

7.48 Recommendation. The Canada Revenue Agency should develop and implement a formal process to ensure that it monitors consistently whether a registered charity has transferred its assets as required when its status is revoked.

The Agency's response. Agreed. The Agency will develop and implement a centralized monitoring process by the end of 2011.

The Agency communicates well with charities and donors

7.49 The report of the Joint Regulatory Table recommended a number of improvements related to educating the charity sector and the public. The Agency responded by

- introducing outreach programs,
- developing an education program, and
- increasing its client assistance.

7.50 The Agency provides charities and donors with information in a variety of formats to ensure accessibility. Guides and publications are available in hard copy and on the Agency website. The Agency maintains a toll-free telephone number dedicated to responding to charity-related queries. Webinars are held and there is an active charity outreach program. Overall, we found that the information is available in a variety of media and the Agency continues to develop user-friendly approaches to delivering information to targeted audiences.

7.51 A range of information is available to the general public about registered charities, such as contact information and a general account of the charity's activities. In addition, the Agency makes public selected annual return information once the charities file their returns. Registered charity status can be checked online, by mail, or by telephone to see whether a charity is currently registered, is under suspension from issuing tax receipts, or has had its charitable status revoked.

7.52 We examined whether the Agency has a process in place to ensure that the information it provides is accurate. As new information is put on the website, the Agency has a quality control process to ensure its accuracy. When revising or updating information to the website, as required, internal groups at the Agency, such as the Web Committee, Legal Services, and the Rulings Directorate, review the new information for accuracy.

7.53 The toll-free charity line has a service standard related to how quickly a telephone call is answered: 80 percent of calls must be answered within two minutes. The measurement provides the Agency with assurance that responses are accessible and timely. However, the Agency was not monitoring or evaluating the quality of the responses provided. In 2010, the Agency intends to add silent monitoring of random telephone calls to monitor the quality and consistency of the information provided.

7.54 As communication is an ongoing activity, it is important to evaluate the approach to ensure that user needs continue to be met. We found that the Agency solicits user feedback, with evaluations of individual information sessions and web-based feedback.

Tax shelter gifting arrangements

Tax shelter—A tax shelter may be an investment in property or a gifting arrangement (an arrangement where a participant makes a gift of property acquired to a qualified donee, typically a registered charity).

It is a tax shelter if it is promoted as offering income tax savings; the buyer or donor will have losses, deductions, or credits within the first four years; and the losses, deductions, or credits would be equal to or more than the net cost of the investment or of the property acquired under the gifting arrangement.

7.55 A **tax shelter** can be a legitimate way for a taxpayer to reduce taxes. In one type of tax shelter, called a "tax shelter gifting arrangement," a taxpayer (called a "participant") makes a donation to a charity through a tax shelter. The Canada Revenue Agency has expressed concerns about some tax shelter gifting arrangements and has issued a number of news releases and tax alerts warning taxpayers about them. In many cases, charities involved in these arrangements are issuing donation receipts in excess of the cash invested or property donated, and often the cash received is not used for charitable purposes.

7.56 One example of a tax shelter gifting arrangement is called a "gifting trust arrangement," in which the participant becomes a beneficiary of a trust and receives property as a distribution from the trust. The participant then donates this property along with an amount of cash to a registered charity and receives donation receipts for the total of the cash and purported fair market value of the property. Typically, the total cash the participant pays is about 30 percent of the amount on the donation receipt. The Agency has denied these types of donations in their entirety, taking the position that there was no gift.

7.57 The Department of Finance Canada released draft amendments to the *Income Tax Act* on 5 December 2003, to limit the tax benefits of charitable donations made under tax shelters and other arrangements. The amendments responded to concerns about these tax shelter gifting arrangements and addressed other changes proposed in the 2003 federal budget. The Agency's position was that the proposed legislation would reduce the donation to no more than the actual cash payment. Although the legislation died on the order paper in 2008 when Parliament was dissolved, it effectively put a stop to a type of arrangement called the "buy-low, donate-high" tax shelter gifting arrangement.

The Agency issues tax shelter identification numbers to all promoters of tax shelter gifting arrangements with complete applications

Promoter—The person(s) who

- sells, issues, or promotes the sale, issuance, or acquisition of the tax shelter;
- acts as an agent or advisor; or
- accepts consideration in respect of the tax shelter

7.58 The *Income Tax Act* requires the **promoter** of a tax shelter to obtain a tax shelter identification number, the purpose of which is to allow the Agency to identify and track tax shelters and determine whether to audit them. A tax shelter may have multiple promoters.

7.59 The *Income Tax Act* requires the Agency to issue an identification number when the application contains certain required information such as a copy of an offering memorandum, and a statement that the promoter will keep the books and records in Canada. The Agency

cannot audit the tax shelter gifting arrangement at the time it issues the identification number because the transactions have not yet taken place. It simply ensures the completeness of the application. As the Agency has received considerable information about the arrangement, it does a preliminary risk assessment to decide whether the arrangement is likely to be abusive and whether it should be audited at a later date.

7.60 The *Income Tax Act* requires that the following wording be put on every written statement that refers to the identification number of the tax shelter:

> The identification number issued for this tax shelter shall be included in any income tax return filed by the investor. Issuance of the identification number is for administrative purposes only and does not in any way confirm the entitlement of an investor to claim any tax benefits associated with the tax shelter.

7.61 As of 31 March 2009, approximately 50 tax shelter gifting arrangements had obtained identification numbers since they were first required to do so in 2003. The number of active tax shelter gifting arrangements between April 2006 and March 2009 was 8 or 9 per year, and the number of new ones obtaining identification numbers each year has declined since 2003. Some promoters switched to new arrangements to get around the proposed legislative changes, and promoters continue to request identification numbers for arrangements that they claim comply with both existing legislation and draft legislative proposals.

The Agency issues general warnings to taxpayers about abusive tax shelter gifting arrangements

7.62 In 2007, the Agency introduced the Taxpayer Bill of Rights explaining what taxpayers can expect in dealing with the Agency. These include

- the right to privacy and confidentiality, and
- the right to expect the Agency to warn taxpayers about questionable tax schemes in a timely manner.

The Agency explains that taxpayers can expect it to provide timely and relevant information about questionable tax schemes that it intends to scrutinize so that taxpayers can recognize and avoid falling into tax schemes that could put them at odds with Canada's tax laws. The Agency states that it strives to provide information that will help taxpayers understand how to protect themselves against tax schemes

and understand the consequences they may face as a result of participation in them.

7.63 The Agency maintains that it cannot disclose names of tax shelter gifting arrangements, the promoters, or the charities involved before auditing them, due to the restrictions on disclosing taxpayer information under the *Income Tax Act*. The challenge for the Agency is to provide information that is timely and as detailed as possible regarding possibly abusive tax shelters, while respecting the confidentiality of the taxpayer information.

7.64 When it issues an identification number to a tax shelter gifting arrangement, the Agency does not communicate any concerns it may have with that specific arrangement to taxpayers. It uses tax alerts to provide only general cautions about arrangements the Agency considers questionable. The Agency has repeatedly warned taxpayers that tax shelter numbers are used for identification purposes only. In a 2008 Tax Alert, the Agency said:

> A tax shelter with an identification number does not guarantee that taxpayers are entitled to receive the proposed tax benefits. Taxpayers should avoid all schemes that promise donation receipts for three to four times the cash payment.

7.65 We found that, given the Agency's interpretation of the limitations on the information it can disclose, the Agency has made reasonable efforts to warn taxpayers about abusive tax shelter gifting arrangements.

The Agency has reassessed tens of thousands of participants in tax shelter gifting arrangements

7.66 Despite the Agency's tax alerts and the promoter's mandatory disclosure, some taxpayers continue to invest in tax shelter gifting arrangements. The Agency estimated that, as of 31 December 2009, there have been approximately 172,300 participants in these arrangements, with $5.4 billion in reported donations. The number of participants and the amount of donations claimed has been declining each year from a peak in 2006.

7.67 The Agency makes it clear that it intends to audit all those involved with tax shelter gifting arrangements—the promoters, the registered charities, and the participants. As of 31 March 2009, the Agency had completed over 69,000 reassessments of taxpayers who participated in tax shelter gifting arrangements and had denied almost $2 billion in charitable donations.

7.68 A participant who disagrees with a reassessment has the right to object by filing a Notice of Objection with the Agency. Of those who are reassessed for participation in a tax shelter gifting arrangement, most file a Notice of Objection. If participants lose their appeal at the objection stage, they can proceed to court, and many of them do. We noted in at least one case that promoters discussed possible objections or court actions when marketing the tax shelters.

7.69 After the Agency conducts an audit of a registered charity that participated in a tax shelter gifting arrangement, it may revoke that charity's registration. The Agency may then issue a news release and post the information on its website. Between April 2006 and March 2009, the Agency issued 11 news releases about revoking the registration of charities participating in abusive tax shelter gifting arrangements.

7.70 For example, on 17 November 2008, the Agency issued a news release after revoking the charitable registration of a charity that had issued receipts for cash received from a tax shelter with an identification number. The Agency stated the following:

> The Charity's sole activity during the audit period was its participation in the donation arrangement; no charitable activities have been conducted by the Charity prior to or after its participation aside from the gifting of approximately $18,000 to qualified donees.

According to the Agency, the charity issued official donation receipts for cash and property in excess of $6.7 million.

7.71 Although very few registered charities are involved with tax shelter gifting arrangements, their actions could have an impact on the whole charitable sector and cause some donors to stop making donations to those charities that are not involved in abusive tax shelters.

7.72 The Agency releases information about specific tax shelter gifting arrangements when the charities involved have had their registration revoked since the *Income Tax Act* permits this. However, this occurs after taxpayers have participated in the tax shelter gifting arrangement.

7.73 The Agency has made progress in reducing taxpayers' participation in tax shelter gifting arrangements, as seen in the decline in applications for tax shelter identification numbers and a decline in the number of participants and donations claimed. However, the

industry still exists and the Agency must continue to invest time and resources to ensure that it stays on top of this issue. Some taxpayers will continue to buy into an arrangement that is too good to be true, despite the cautions of the Agency and the media.

Conclusion

7.74 The Canada Revenue Agency has processes designed to increase compliance with the *Income Tax Act* related to registered charities. The registration process works well and is thorough. The Agency could improve its process for dealing with late-filed annual information returns, and it does not have sufficiently detailed internal guidance to apply sanctions. In addition, random audits may not produce reliable measures of compliance.

7.75 The Agency has designed processes to detect non-compliance related to tax shelter gifting arrangements, within the constraints of the *Income Tax Act*. The Agency identifies and audits tax shelter gifting arrangements. However, promoters continue to request and receive identification numbers if their applications are complete. Many taxpayers are reassessed for investments made in these arrangements.

7.76 The Agency's communication processes for charities and donors are well-designed. The Agency distributes information in a variety of media and focuses on educating charities and the public. For tax shelter gifting arrangements, the Agency issues tax alerts and news releases. However, it does not release specific information about questionable tax schemes when a tax shelter identification number is issued due to its obligation to maintain the confidentiality of taxpayer information.

About the Audit

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by The Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

Objectives

The objective of the audit was to determine whether the Canada Revenue Agency had processes designed to increase compliance with the charities provisions of the *Income Tax Act*.

We conducted our audit with the following three lines of enquiry, each with its own sub-objective:

- **Registered charities.** Determine whether the Agency has processes designed to increase compliance with the Act related to registered charities.
- **Tax shelter gifting arrangements.** Determine whether the Agency has appropriate processes designed to increase compliance with the Act related to tax shelter gifting arrangements.
- **Communications.** Determine whether the Agency's communication processes are designed to increase donors' and charities' level of awareness of the charities provisions of the Act.

Scope and approach

The audit focused on three areas that deal with the administration of the charities provisions of the *Income Tax Act*:

- the activities that the Agency undertakes to register, monitor, and review registered charities;
- the process that the Agency uses to identify, monitor, and review tax shelters that use the charities provisions of the Act; and
- the way the Agency communicates the obligations, under the Act, of registered charities and entitlements of their donors.

In conducting our audit, we requested and reviewed documents and reports from the Agency. As well, we analyzed databases relating to applications for registration, audits planned and completed by the Agency relating to charities and tax shelters, and revocations and wind-ups. Our review of applications for registration included the random sampling of 45 files over the three-year period of our audit. Our sample was chosen in accordance with statistical sampling methodology to give a high level of assurance that controls were operating effectively. A sample size of 45 is sufficient to project the entire population of 12,031 with an expected error rate of 0 percent, a confidence interval of +5 percent, and a confidence level of 90 percent.

To confirm our understanding of the information we received, we interviewed Agency staff at various levels and locations. We visited four Tax Services Offices and conducted interviews with auditors, team leaders, and assistant directors of audit. At the Agency's headquarters, we met with staff in the

Compliance Programs Branch, the Charities Directorate of the Legislative Policy and Regulatory Affairs Branch, and the Appeals Branch.

The audit did not examine Agency activities related to the following:

- provincial authorities on charities (governance issues),
- political contributions,
- non-profit organizations, and
- the Quality Management Framework for the accuracy of communications.

Criteria

To determine whether the Agency has processes designed to increase compliance with the *Income Tax Act* related to registered charities, we used the following criteria:	
Criteria	**Sources**
The Canada Revenue Agency has a process that determines the eligibility of a potential registered charity.	*Income Tax Act*, subsections 149.1(1) and 248(1)
The Agency meets its established service targets for registration of simple and regular applications.	Canada Revenue Agency Annual Report to Parliament 2008–2009
The Agency has an audit and review process that determines a registered charity's eligibility for continued registration.	• *Income Tax Act*, sections 149.1, 168, 230-231.5, subsection 220(1) • *Income Tax Regulations,* sections 3500–3504
The Agency has incorporated risk management into its audit planning activities to identify current and emerging compliance threats.	Canada Revenue Agency Annual Report to Parliament 2008–2009
The Agency has a procedure in place that applies taxes and minor, intermediate, and severe penalties.	Budget 2004, Department of Finance Canada
The Agency has procedures in place that confirm the appropriate wind-up of a registered charity.	*Income Tax Act*, subsections 149.1(2)–149.1(4.1), 168(1), and 188(1.1)
To determine whether the Agency has appropriate processes designed to increase compliance with the *Income Tax Act* related to tax shelter gifting arrangements, we used the following criteria:	
Criteria	**Sources**
The Agency has an appropriate process in place that identifies tax shelter gifting arrangements.	• *Income Tax Act*, section 237.1 • *Income Tax Regulations*, subsection 231(6)
The Agency has appropriate processes in place that detect questionable tax shelter gifting arrangements.	• Taxpayer Bill of Rights • *Income Tax Act*, section 237.1
The Agency has an appropriate process in place that applies penalties regarding tax shelter gifting arrangements.	*Income Tax Act*, subsections 163(2), 237.1(7.4), and 239(2.1)

To determine whether the Agency's communication processes are designed to increase the level of awareness of donors and charities, we used the following criteria:	
Criteria	**Sources**
The Agency's information regarding registered charities is accurate, accessible, and available in a timely manner.	• Canada Revenue Agency Communications Policy • Budget 2004, Department of Finance Canada • Taxpayer Bill of Rights
The Agency has evaluated and improved the communication process regarding charities and tax shelters.	Canada Revenue Agency Communications Policy
The Agency has a process to warn donors about questionable tax schemes.	Taxpayer Bill of Rights

Management reviewed and accepted the suitability of the criteria used in the audit.

Period covered by the audit

The audit covered the period from April 2006 to March 2009. Audit work for this chapter was substantially completed on 8 June 2010.

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Appendix List of recommendations

The following is a list of recommendations found in Chapter 7. The number in front of the recommendation indicates the paragraph where it appears in the chapter. The numbers in parentheses indicate the paragraphs where the topic is discussed.

Recommendation	Response
Registered charities	
7.27 The Canada Revenue Agency should evaluate whether its current process for dealing with annual information returns meets its objective of increasing compliance and receiving returns on time. **(7.22–7.26)**	Agreed. An evaluation of the current process for dealing with late-filed returns will be completed by September 2011.
7.37 The Canada Revenue Agency should develop and execute a random sampling plan to meet its commitment to report a compliance rate for registered charities. **(7.33–7.36)**	Agreed. The Agency will develop a revised random sampling plan for implementation in the 2011–12 fiscal year.
7.43 The Canada Revenue Agency should evaluate the effectiveness of its use of various tools, such as sanctions and compliance agreements, to increase registered charities' compliance with the *Income Tax Act*. The Agency should also develop, document, and implement detailed internal guidance to clarify when and how sanctions should be applied. **(7.38–7.42)**	Agreed. The Agency is already evaluating the effectiveness of compliance agreements and will evaluate the effectiveness of its use of tools in the next two to three years. The Agency has taken steps to develop internal guidance with respect to the application of sanctions and to strengthen the process for applying these sanctions. The Agency will continue to make improvements and will provide further guidance on the application of sanctions by March 2011.
7.48 The Canada Revenue Agency should develop and implement a formal process to ensure that it monitors consistently whether a registered charity has transferred its assets as required when its status is revoked. **(7.44–7.47)**	Agreed. The Agency will develop and implement a centralized monitoring process by the end of 2011.

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2010



Report of the

Auditor General of Canada

to the House of Commons

FALL

Chapter 8

Facilitating the Flow of Imported Commercial Goods—Canada Border Services Agency

Office of the Auditor General of Canada



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Facilitating the Flow of Imported Commercial Goods—Canada Border Services Agency

Office of the Auditor General of Canada

The Fall 2010 Report of the Auditor General of Canada comprises Matters of Special Importance, Main Points—Chapters 1 to 9, Appendices, and nine chapters. The main table of contents for the Report is found at the end of this publication.

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Chapter

8

Facilitating the Flow of Imported Commercial Goods—Canada Border Services Agency

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Facilitating the Flow of Imported Commercial Goods—Canada Border Services Agency

Main Points

What we examined

The Canada Border Services Agency is the lead federal agency for operations at border ports of entry. Under the *Canada Border Services Agency Act*, the Agency has a dual mandate to provide integrated border services that support national security and public safety priorities and that facilitate the free flow of persons and goods that meet all regulatory requirements. The Agency works with other partners to provide these services.

We examined how the Agency fulfills the second part of its mandate, which is to provide integrated border services that facilitate the free flow of imported commercial goods and collect the revenues owed. The Agency has interpreted facilitation to mean minimizing administrative costs, minimizing intervention in the movement of goods, and minimizing delays, to the greatest possible extent while managing risks and ensuring compliance with regulatory requirements.

We examined the Agency's systems and practices for collecting and processing information to assess risk before goods arrive at the border, providing examination facilities and ensuring that they are adequate, developing service standards and monitoring performance against them, and assessing and collecting duties and taxes. We did not examine the Agency's responsibilities and activities related to unlawful or non-commercial goods being imported or exported; commercial goods being imported or exported by post; goods in transit or temporary admission of vessels for coastal trade; or the entry, detention, or removal of travellers.

Audit work for this chapter was substantially completed on 31 May 2010.

Why it's important

In the 2008–09 fiscal year, the Agency provided commercial services for 217,000 importers, 3,000 carriers, and 250 licensed brokers. It processed about 12 million commercial import transactions and more than 29 million low-value courier import transactions, many of which were also commercial goods. The Agency is the government's second

largest tax collector. It reported collecting $23 billion in import tax revenues in 2008–09, almost all of which was from commercial goods.

Canada imports large volumes of goods every year. From 2005 to 2008, Canadian imports of goods rose from $388 billion to $443 billion. The Organization for Economic Co-operation and Development reported that about 28 percent of the goods consumed by Canadians in 2008 were provided by imports. Imports are also critical components of many Canadian exports.

The process of importing goods adds to importers' costs, including those associated with transportation, required examinations, and providing information to government organizations. Canadians benefit when these costs are minimized, because any increases can weaken the competitive position of Canadian industries, and because cost increases may also be passed on to the consumer. Members of the trade community have indicated that they want the Agency to deliver border services in an open and transparent manner so that the commercial importing process is more predictable and consistent.

What we found

- The Agency's systems and practices facilitate the flow of imported commercial goods. However, there are still some limitations that lead to inconsistent levels of facilitation, depending on where and when the goods enter the country. The Agency has undertaken two initiatives—the eManifest project and the Single Window Initiative—to align its operations with the best-case scenario of moving low-risk shipments through the border with minimal intervention. These initiatives aim to further automate and integrate the information the Agency requires from importers to assess risk.
- The Agency does not have reasonable assurance that the information provided electronically by commercial clients at various stages of the importing process is accurate, complete, and timely. Its monitoring process is unsystematic and limited in scope, which has an impact on the Agency's ability to effectively assess risk. The Agency has recognized this gap and has plans designed to provide it with better information about the extent to which the data it receives is accurate, complete, and timely.
- The Agency has established service standards for many of its key services to importers, such as processing times for electronic information and wait times at land border crossings. However, some of these standards cannot be measured accurately and the results are published only for land border wait times. Without better published information, the importing process is less predictable and it is difficult for importers to make informed business decisions about

how, when, and where to import goods. The Agency has begun to develop a service strategy to address these issues.

- The Agency does not have reasonable assurance that commercial clients' assessments of duties and taxes owed are based on accurate information. Without such assurance, the Agency cannot verify that assessments are correct and that it is collecting the correct revenues owed. It also risks providing other government organizations, such as Statistics Canada and the Department of Finance Canada, with inaccurate and incomplete trade and revenue information. The Agency has recognized this gap and is working on a strategy to address it.

The Agency has responded. The Agency agrees with all of our recommendations. Its detailed responses follow the recommendations throughout the chapter.

Introduction

Importance of imports to Canada

8.1 Canada imports large volumes of goods every year. From 2005 to 2008, the value of Canadian imports of goods rose from $388 billion to $443 billion, before declining to $374 billion in 2009, during the recent recession. The Organisation for Economic Co-operation and Development reported that about 28 percent of the goods consumed by Canadians in 2008 were imports. In addition to supporting Canada's standard of living, imported goods are used to produce many Canadian exports.

8.2 The process of importing goods adds to importers' costs, including those associated with transportation, required examinations, and providing information to government organizations. Canadians benefit when these costs are minimized, because any increases can weaken the competitive position of Canadian industries, and because cost increases may also be passed on to the consumer.

The Canada Border Services Agency's mandate to facilitate imports

8.3 The Canada Border Services Agency is the lead federal agency for operations at border ports of entry. According to the *Canada Border Services Agency Act*, the Agency has a dual mandate to provide "integrated border services that support national security and public safety priorities and facilitate the free flow of persons and goods, including animals and plants, that meet all requirements under the program legislation." Exhibit 8.1 provides information about the Agency's activities in the 2008–09 fiscal year.

8.4 Although the mandates of security and safety and facilitation are not easily separated, our 2007 audit—in the 2007 October Report of the Auditor General, Chapter 5, Keeping the Border Open and Secure—examined whether the Agency's approach to border management achieved the desired levels of border openness and security. Our current audit examines the other part of the Agency's mandate—facilitation, that is, how the Agency integrates its border services to facilitate the free flow of imported commercial goods and how it collects the revenues owed under legislation.

8.5 The Agency has interpreted facilitation to mean minimizing administrative costs, minimizing intervention in the movement of goods, and minimizing delays, to the greatest extent possible—while

Exhibit 8.1 Information about the Canada Border Services Agency's activities in the 2008–09 fiscal year

Number of employees	14,600
Major commercial points of service*	• 23 land crossings (designated commercial offices) • 13 international airports • 3 marine ports
Commercial clients	• 217,000 importers • 3,000 carriers • 250 licensed brokers • 49 freight forwarders
Number of shipments	• 12 million commercial import transactions • 29.5 million low-value (less than $1,600) courier import transactions, many of which were also commercial goods
Revenues collected	Total: $23 billion, as follows: • $18 billion in goods and services tax • $4 billion in import duties • $1 billion in excise taxes and non-tax revenues

*The Agency may also process some commercial goods at its smaller points of service.

Source: Canada Border Services Agency

undertaking the processes necessary to manage risks to national security and public safety, and to ensure compliance with regulatory requirements.

8.6 Processing imports is a service that the Agency provides to commercial clients when they import goods into Canada. The Agency must offer this service at the same time as it addresses broader public interests, policy requirements, and resource limitations. The Government of Canada's long-standing commitment to improving service delivery requires that federal organizations determine their clients' service priorities and develop service standards and targets. It also requires that these organizations use these standards and targets to measure performance and continuously improve service. Through consultations, commercial clients have indicated that they want the Agency to deliver services in an open and transparent manner so that the commercial importing process is more predictable and consistent. This will help them make informed business decisions about how, when, and where to import goods.

Commercial clients—Businesses that participate in the importing process and that use Canada Border Services Agency services—specifically importers, brokers, carriers, and freight forwarders

8.7 More information on the federal government's service improvement agenda can be found in Chapter 3, Service Delivery, of this report.

Importing commercial goods

8.8 Commercial goods are imported into Canada through a process largely established by the *Customs Act*, under which all goods must be reported to the Agency. The Agency determines whether those goods will be **released** into Canada.

Release—A decision by the Canada Border Services Agency to allow goods to leave customs control and enter the Canadian economy. This may occur at border points of entry or at inland points of service.

8.9 For air and marine shipments, carriers and freight forwarders must send conveyance and cargo data to the Agency before the shipment arrives in Canada. The Agency uses this information to decide whether the shipment will be allowed to enter Canada.

8.10 Importers—or exporters, in the case of courier shipments—must provide another set of more detailed information about the goods and the importer, which may be provided before or after the shipment arrives in the country. The Agency uses this information—most of which is submitted electronically—to decide whether to release the goods into Canada. Under legislation and regulations, commercial clients are required to provide accurate and complete information.

8.11 Border services officers use automated systems, as well as their own judgment, to determine whether a shipment represents a high risk and, therefore, should be held for examination. If an officer decides that an examination is not required, the goods are released. If it is determined that an examination is required, the goods are directed to an examination facility and are released only after they pass the examination. Shipments can be examined at a number of facilities, some at the border, some inland, and some at a foreign port of loading.

8.12 Whether a shipment is selected for examination, and how long that examination takes, affects how quickly the commercial shipment enters the country. Commercial clients pay the cost of offloading the shipment for examination. For example, in early 2010, the trade community estimated that the average cost to examine a marine container was $1,000. Other costs, such as drivers' wages and fees for late deliveries, may also be borne by importers.

8.13 Once imports have been released, importers assess the taxes and duties they owe—mainly under the *Customs Tariff Act*, *Excise Act*, *Excise Tax Act*, and *Special Import Measures Act*—and report this information to the Agency. The *Customs Act* allows importers with account security to accumulate the amounts they owe over the course

of a month, and pay the total at the end of the month. Most importers take advantage of this provision.

8.14 Once the taxes and duties have been paid, the Agency checks a sample of importers to verify that they have reported the goods properly and paid all taxes and duties. This process is known as compliance verification. Exhibit 8.2 describes the process for importing goods into Canada.

Exhibit 8.2 Summary of the process for importing commercial goods into Canada

Stages	Responsibilities	
	Commercial clients	**Canada Border Services Agency**
Pre-arrival	• Submit advance commercial information for risk assessment purposes (electronic) (air and marine only). • Submit declaration documents (paper, electronic, and other government entry permits) prior to the arrival of the shipment; most are submitted prior to arrival. • **Trusted traders** are not required to provide advance transactional information.	• Screen shipments—using electronic information, risk scores, and targets generated through automated systems—to identify threats to national security, public safety, and regulatory requirements. • Decide whether to reject a shipment or refer it to secondary examination.
Primary inspection (at port of entry)	• Submit declaration documents (paper, electronic, other government entry permits) or proof of membership in trusted trader programs. • Wait for the Agency's decision.	• Screen shipments, using declaration documents and targets in the computer system. • Decide whether to refuse entry, allow to proceed inland, release the shipment, or refer it to secondary examination.
Secondary examination (at border facility or inland warehouse)	• Wait for completion of examination.	• Examine the shipments for contraband, regulatory, and trade requirements. • Decide whether to release, refuse entry, or seize the shipment.
Accounting and payment	• Submit assessment and reporting documents on goods. • Make payments.	• Confirm amounts owing. • Accept payments.

Trusted traders—Companies that are members of one or more of the following Canada Border Services Agency programs: Free and Secure Trade, Partners in Protection, and Customs Self-Assessment. Because these companies have met certain system and risk requirements and are subject to audit by the Agency, they are trusted and considered low-risk.

Exhibit 8.2 Summary of the process for importing commercial goods into Canada (continued)

Stages	Responsibilities	
	Commercial clients	Canada Border Services Agency
Post-release verification	• Make books and records available to the Agency so the assessment and reporting information can be verified. • If required by the Agency, correct assessment and reporting errors and pay additional duties, taxes, and interest (within 90 days).	• Review importer's accounting systems, books, and records. • Verify the country of origin, value, and tariff classification. • Verify permits. • Monitor that corrections are made.

Focus of the audit

8.15 The objective of the audit was to determine whether the Agency's integrated border services facilitate the free flow of imported commercial goods and collect the revenues owed on those goods. We examined the Agency's systems and practices for

- collecting and processing information for risk assessment purposes,
- ensuring provision of adequate examination facilities,
- developing service standards and monitoring performance against them, and
- assessing and collecting duties and taxes.

8.16 More details about the audit objectives, scope, approach, and criteria are in **About the Audit** at the end of this chapter.

Observations and Recommendations

Facilitating commercial shipments

8.17 According to the service policies of the Treasury Board, as well as importing processes established in legislation and its own mandate, the Canada Border Services Agency must take the following steps to facilitate the import of commercial goods:

- Automate and integrate information collection for risk assessment, in consultation with the trade community—to minimize administrative costs to commercial clients.
- Ensure that the information it uses to conduct risk assessments is accurate, complete, and timely, and that it selects shipments for

examination on the basis of risk—to minimize intervention in the movement of goods.

- Process information promptly and have the necessary facilities to process shipments through the border and to conduct examinations as quickly as possible—to minimize delays.
- Engage in public consultation to develop and publish service standards and targets, use these to measure and report on performance, and continuously improve service—to process commercial goods in a transparent, predictable, and consistent manner.

8.18 Overall, we found that the Agency's systems and practices facilitate the flow of imported commercial goods. However, there are still some limitations that lead to inconsistent levels of facilitation, depending on where and when the goods enter the country. The Agency has plans designed to address these limitations.

The Agency is working to further automate and integrate systems for information collection

8.19 The best-case scenario in the importing process is when a low-risk shipment moves through the border with minimal intervention, with risk assessment and release decisions based on the necessary electronic information that was provided before the goods arrived at the port of entry. The Agency currently receives most of its risk assessment and release information electronically, and prior to the arrival of the shipment. It is working to facilitate the commercial import process by designing its operations with this best case in mind, that is, by further automating and integrating its information requirements for risk assessment through two initiatives—**eManifest** and the **Single Window Initiative**.

eManifest—An information system through which commercial clients will be required to submit cargo, crew, conveyance, and importer information to the Canada Border Services Agency, within prescribed time frames, prior to arrival of a shipment at the border.

Single Window Initiative—A project to expand the number of other government department programs that interact electronically with the Canada Border Services Agency.

8.20 By the time it is fully implemented in 2014, the eManifest project will require most participants in the importing process—importers, freight forwarders, and cargo carriers—to electronically submit full risk assessment information, within specified time frames, before their goods reach Canada. The Agency expects that this project will provide it with information that is timelier and better designed for risk assessment purposes. This will increase the amount of information that commercial clients are required to provide to the Agency. However, the Agency expects that any increased costs that the client incurs as a result of this requirement, will be partly offset by improved risk assessment and reduced scrutiny of low-risk shipments.

8.21 In addition, the Agency is working to reduce the cost of providing information under the eManifest project, based on feedback from its commercial clients. First, it modified its requirements for the type of information to be provided and for the way the information will be provided. Second, at the time of our audit, the Agency was examining options to expand its Trusted Trader programs. Because Trusted Trader participants undergo a risk assessment before they are accepted in these programs, they are allowed to provide less information than non-participants about each shipment.

8.22 eManifest is complemented by the Single Window Initiative, which is intended to streamline border clearance processes and to reduce the paper burden through the increased sharing of electronic information between the Agency and other government departments. Some imported commercial goods are subject to the import requirements of other government departments and agencies, but the Agency plays a role in administering these requirements. The Agency administers about 25 programs that impose additional requirements on commercial imports, on behalf of 14 other government departments. Only four of these programs—one each from Natural Resources Canada, the Canadian Food Inspection Agency, Foreign Affairs and International Trade Canada, and Transport Canada—have electronic interfaces with the Agency; the remainder are paper-based.

8.23 In 2005, the Agency received $10 million over five years for the Single Window Initiative. Over this five-year period, the Agency analyzed data and legislative requirements, and developed business models. At the time of the audit, the Agency was planning to implement additional electronic links to transfer commercial data to some other government departments as pilot projects. However, expanding the Single Window Initiative, to further reduce paper-based processes and increase sharing of electronic information, depends on the Agency working with other government departments to identify additional sources of funding.

Quality assurance of electronic information needs improvement

8.24 To make the best use of electronic information, in order to minimize intervention in the movement of goods through effective risk assessment, the Agency needs reasonable assurance that this information is accurate, complete, and timely. At the time of our audit, the Agency did not have a monitoring process in place to gain such assurance.

8.25 We examined the Agency's approach to monitoring the quality of electronic information provided by commercial clients at various stages in the importing process. We found that the Agency has conducted a number of studies and pilot projects to examine whether the electronic information submitted accurately describes the goods that are being brought into the country. However, these studies are limited in scope; they often examine information quality at only one point in the importing process, and most are not conducted consistently over time.

8.26 The studies found that between 7 and 21 percent of the information provided by commercial clients was inaccurate. For example, a national study conducted by the Agency in 2009 found that, in about 14 percent of cases, the **tariff classification** provided by the importer at the time of release was significantly different from the one provided when the duties and taxes were assessed. This means that the description used to decide whether to release or examine the good was not the same as the one used later to assess the duties and taxes owed. According to the Agency, such inaccuracy has an impact on its ability to assess the risk that the shipment poses to the health, safety, and security of Canadians, before releasing it.

Tariff classification—A 10-digit code assigned to every traded commodity. This code is used to assess risk, identify the rates of duty applicable to the commodity, and distinguish commodities for national trade statistics. It is based on the Harmonized Commodity Description and Coding System, which was developed and is maintained by the World Customs Organization, and is sometimes referred to as the "HS Code."

8.27 Because the Agency does not regularly monitor data quality, it does not know whether the quality of the electronic information provided by commercial clients is improving. It also does not know whether the results of its studies are good or bad, that is, whether error rates reflect acceptable levels of accuracy, completeness, and timeliness. The Agency is planning to pilot a monitoring program for its **Courier Low Value Shipment Program** in 2010 and a Commercial Programs Compliance Plan in early 2011. These plans are intended to provide the Agency with baseline information that it can use to assess whether the information it receives is accurate, complete, and timely.

Courier Low Value Shipment Program—A program for approved courier companies that expedites the release of qualifying shipments valued at less than $1,600. Duties and taxes are paid monthly.

8.28 **Recommendation.** The Canada Border Services Agency should improve its systems and practices for monitoring the quality of electronic information that it receives during the commercial importing process—to obtain reasonable assurance that this information is accurate, complete, and timely. The Agency should then use the results of its monitoring process for continuous improvement.

The Agency's response. Agreed. As the Auditor General has acknowledged, the Agency has begun to address possible gaps in the commercial import process, in part through the development of the Commercial Programs Compliance Plan, a pilot project that will be

initiated in spring 2011 with full implementation in 2012. The Agency is also enhancing monitoring of commercial import process data transmission requirements and is developing a comprehensive monitoring framework as part of the eManifest project. These compliance monitoring processes will be put in place in fall 2010 to support the initial implementation of eManifest in the highway mode.

By 2014, systems will be in place to enable the Agency to assess risk and compare commercial information from the pre-arrival through to the post-release phases of the import process. Legislative and regulatory changes related to eManifest will prescribe that specific parties within the trade chain will be held liable for the accuracy and timeliness of this information.

The Administrative Monetary Penalty System (AMPS) program is another tool that the Agency uses to encourage importers and exporters to comply with trade laws and regulations, as well as laws it enforces on behalf of other government departments. The program includes penalties for inaccurate, incomplete, and untimely transmission of trade data. The Agency will further develop the AMPS program to provide compliance support for new initiatives, such as the eManifest project, as each phase of the project is implemented.

Taken together, these initiatives will ensure that the electronic information received from clients is increasingly accurate, complete, and timely.

A more consistent risk-based approach to selecting shipments for examination is needed

8.29 Examining shipments is necessary to mitigate risk and verify compliance. However, examining a shipment increases commercial clients' costs and can delay their imports. To minimize intervention in the movement of goods, the Agency needs to process information promptly and use that information to select shipments with a risk of non-compliance. Such a risk-based approach also requires the Agency to conduct some random examinations.

8.30 We found that, in the case of Trusted Trader programs, the Agency uses a risk-based approach to select shipments for examination. This practice facilitates the import of goods because low-risk shipments are selected for examination less often. According to Agency data, participants in Trusted Trader programs have lower examination rates than other commercial clients. Since members in these programs have been assessed in advance and deemed low-risk, this result is consistent with a risk-based approach.

8.31 We examined whether the Agency treats commercial clients consistently, by assessing whether the frequency of examinations at each port reflects the risk posed by shipments entering Canada at that port. We found that examinations did not align with the **risk rating** that the Agency assigned to each port.

Risk rating—A measure of the relative risk of goods moving through a port of entry.

8.32 The Agency told us that the factors it considers when deciding how many examinations to conduct are not strictly risk-based. As a result, commercial clients may not be treated consistently and the intervention in the movement of goods is not minimized at some ports of entry.

8.33 The Agency has recognized the need to improve its risk-based approach to examinations. It recently developed a Border Risk Management Plan, which is expected to be implemented in the 2010–11 fiscal year. One of the plan's goals is to better align expected examination rates, by port of entry, with the port's risk rating.

Most major examination facilities are adequate, but there is a lack of monitoring mechanisms for licensed warehouses

8.34 The Agency owns many facilities at ports of entry, including at several larger land-border crossings and many smaller ports of entry. At these locations, the Agency is responsible for providing its own examination facilities. Other ports of entry—including airports, marine ports, and some large land border crossings—are owned by third parties. At these locations, under the *Customs Act* and other acts, the owner or operator is responsible for providing the examination facilities to the Agency free of charge. The Agency also licenses about 1,200 **sufferance warehouses** that are owned by private operators, who are also required to provide adequate examination facilities to the Agency free of charge.

Sufferance warehouses—Privately owned and operated facilities that are licensed by the Canada Border Services Agency for the short-term storage and the examination of imported goods pending their release from Customs. Sufferance warehouse keepers charge fees for storage and handling.

8.35 Through its investment planning process, the Agency has prioritized upgrades to its larger land border crossings. Once the construction projects that were under way at the time of the audit are completed, the Agency will consider most of them adequate to conduct the full range of examinations with minimal delay. The Agency conducts only certain types of examinations at smaller land border ports of entry, and it is not planning to invest a lot more in examination facilities at those locations. Therefore, shipments made through these smaller ports of entry that are selected for examination may be redirected to an alternative examination facility so the required examinations can be completed.

8.36 The Agency also monitors the examination facilities that operators provide under the *Customs Act*. It has assessed most of them as being adequate and, where it found deficiencies, the operator has plans designed for improvement. However, at two major commercial airports—Montreal-Mirabel International Airport and Vancouver International Airport—some of the examination facilities are not provided free of charge as required under the *Customs Act* and other acts. Instead, Public Works and Government Services Canada has been paying for space, leased on behalf of the Agency, at a cost of about $547,000 per year, which represents non-compliance with the *Customs Act* and additional costs for the Government of Canada. The Agency intends to bring these arrangements into compliance with the legislation when the leases expire in 2012.

8.37 An evaluation done by the Agency in 2010 noted that importers and carriers had complained that some highway sufferance warehouses were inadequate. According to the evaluation, the Agency's capacity for identifying deficiencies is limited, and it did not conduct enough monitoring to verify that these warehouses met the requirements of current regulations. The Agency committed to implementing a risk assessment and audit strategy for warehouses by April 2011.

The Agency is working to coordinate service levels for examinations with other government departments

8.38 Examining certain types of shipments, such as pharmaceuticals or explosives, requires the expertise and participation of other government departments. Therefore, to minimize delays, the Agency needs to coordinate service levels for examinations with other government departments and agencies. To determine whether it is clear what levels of service other government departments should provide to the Agency, we examined guidance documents for 13 program areas where the Agency may need to call on the services of other departments and agencies. We found that levels of service were well-defined for 8 program areas but were not for the remaining 5.

8.39 In several cases, the service-level guidance states that, when Agency officers request services from other government departments, they can expect a reply within one to twenty-four hours. However, some of the arrangements exclude weekends and holidays, whereas the Agency's large commercial land border crossings are always open to offer services. This means that if a shipment that requires other government department services arrives on a Saturday, it may not be processed until Monday at the earliest. The Agency publishes only

limited information on these different hours of service—information that commercial clients need to plan the timing of their shipments.

8.40 As part of its work on the Single Window Initiative, the Agency is working with other government departments to improve service levels for examination.

The Agency needs to improve its measurement and reporting on services provided at the border

8.41 To process commercial goods in a transparent, predictable, and consistent manner, the Agency needs to develop and publish service standards and targets. It needs to use these to measure and report on performance and to continuously improve service. Published service standards help commercial clients make informed decisions about when and where to import.

8.42 We found that the Agency had published service standards for processing the information needed to release goods and for **land border wait times**. These service standards measure key processes that determine whether the Agency is minimizing delays in the movement of commercial goods.

Land border wait time—The time it takes, in minutes, for a vehicle to reach the primary inspection booth after arriving at the end of the queue.

8.43 However, there are gaps in the Agency's measurement and reporting against these standards, specifically, the following:

- Some performance is not measured accurately against the standards. For example, to measure performance against the land border wait time standard, border services officers observe traffic and estimate the time it takes to reach the primary inspection line from an arbitrary roadside marker. This information is then uploaded to the Agency's website for 20 of the biggest land border commercial crossings. However, when the line-ups extend beyond the marker, trucks at the end of the line may wait longer than the wait time reported between the marker and the primary inspection line.
- Performance targets have not been set. For example, Agency data indicates that one electronic processing time standard—"release on minimum documentation," which accounted for 14 percent of releases—was met 82 percent of the time during the 2008–09 fiscal year. However, some regions met the standard more than 90 percent of the time, while others met it less than 70 percent of the time. The Agency has not determined which of these outcomes represents adequate service to commercial clients.

- Results are not published for all service standards. The Agency only publishes results for its land border wait time standards. It does not publish the results for its electronic processing service standards for the commercial importing process.

8.44 The Agency has recognized the need to improve measurement and reporting on services provided at the border. In 2008, the Agency began a pilot project, in British Columbia and Southern Ontario, with Transport Canada and the United States Customs and Border Protection to improve the measurement of land border wait times. The project involves using various technologies to measure these wait times in a more systematic and scientific way. Also, in 2010, the Agency began developing a Resource Modelling Framework to determine how to optimize scheduling of border services officers and investments in border infrastructure to minimize land border wait times. The model is scheduled for completion in summer 2011.

The Agency is taking steps to improve predictability of examination times

8.45 The time it takes to conduct examinations varies, making it difficult to predict entry times for shipments into Canada. Because the extent and complexity of examinations can vary significantly, it is not practical to publish precise time standards. However, some information about how long examinations take, such as averages or ranges, would be useful to importers.

8.46 As a first step, the Agency is leading an examination subcommittee of the Border Commercial Consultative Committee to analyze each step in the marine container examination process. Terminal operators and third-party off-loaders have been asked to provide information on how long containers remain in their possession. The Agency told us that it expects this information to show sources of delay in moving these types of shipments. The Agency plans to use information on examination turnaround times to develop a standard for the examination of marine containers.

8.47 In 2009, the Agency also began developing a Client Service Strategy that included the following objectives:

- Establish governance structures.
- Conduct consultations.
- Create an inventory of services.
- Publish service standards.

8.48 We found that the Agency had made some progress toward meeting these objectives, including conducting consultations with commercial clients on how to improve land border wait times. In its 2009–10 Report on Plans and Priorities, the Agency committed to publishing updated service standards by the end of the 2010–11 fiscal year.

8.49 **Recommendation.** The Canada Border Services Agency should improve its measurement of service standards and should collect and publish service information to increase predictability in the commercial importing process.

The Agency's response. Agreed. The Agency has undertaken a three-year service improvement strategy that will strengthen the Agency's commitment to service, enhance the service culture, and simplify and streamline how the Agency and clients interact. One goal of the strategy is to set targets and to measure and publish service standards, ultimately improving predictability for commercial clients and resulting in continued service improvements. External stakeholder input on priorities and recommendations with respect to this initiative is being sought through the Border Commercial Consultative Committee's sub-committees on wait times, examinations, and service standards. As service standards are identified, they will be progressively implemented starting in January 2011.

Under its service strategy initiative, the Agency is developing an inventory of service standards and external services that identifies tasks, outputs, and clients. To guide the consistent development of future service standards and performance measures, the Agency is developing a comprehensive training package; delivery to staff will begin by fall 2010. This will enable specific service line owners to develop new service standards for their programs.

Assessing and collecting duties and taxes

8.50 Under the *Customs Act*, importers self-assess the duties and taxes they owe on imported commercial goods. They provide the assessment information per release to the Canada Border Services Agency and pay the amounts owing at the end of the month. In the 2008–09 fiscal year, the Agency collected $23 billion in duties and taxes through this process, almost all of which was from commercial goods, making it the Government of Canada's second largest revenue collector. As such, the Agency needs systems and practices that provide reasonable assurance that the assessments and information provided by importers are accurate and complete. It also needs a revenue management system that, in addition to efficiently processing payments and

reporting on revenues, will keep pace with technology and current business practices.

The Agency lacks assurance that commercial clients are accurately assessing the duties and taxes they owe

8.51 Country of origin, value of the goods, and tariff classification are used to determine what, if any, duties and taxes are payable on imported goods. Inaccurate information from commercial clients on any of these factors may result in an inaccurate assessment of duties and taxes. This may also affect the accuracy of trade and revenue information provided by the Agency to Statistics Canada and the Department of Finance Canada, as well as the Agency's understanding of whether commercial clients are complying with trade rules.

8.52 To verify the accuracy and completeness of information provided by commercial clients, the Agency selects samples of transactions and conducts compliance verifications—a kind of audit that examines whether importers' records support their transactions. While the Agency's Compliance Verification function also assesses importers' compliance with other government requirements, including policies related to the health and safety of imported commercial goods, our audit focused on its role in verifying the amounts of duty and tax owed by importers.

8.53 The Agency has periodically analyzed some of its compliance verification results. According to studies undertaken since 2005, it is estimated that importers have provided inaccurate information on country of origin or undervalued their imported goods for between 5 and 20 percent of releases and have misclassified between 17 and 30 percent of releases.

8.54 The results of these studies cannot be extrapolated to estimate the revenue the Agency would have collected if all importers had accurately assessed the revenue they owed. However, the Agency's compliance verification work identifies substantial additional revenues owing each year due to the errors in the information provided. In the 2009–10 fiscal year, the Agency conducted about 2,700 compliance verifications, which covered three percent of the value of imports that year, and assessed about $59 million in additional duties and taxes owing from importers.

There are gaps in the Agency's latest compliance verification approach

8.55 Over the years, the Agency has changed its approach to compliance verification several times to try to obtain better

information on compliance trends and to align verification plans with resources. Our audit reports in 1994, 1997, 2001, and 2003 found that the Agency has had difficulties implementing each new approach.

8.56 In 2009, the Agency again adopted a new strategy with the goal of making compliance verification more consistent and risk-based. The strategy includes the following initiatives:

- a risk assessment committee to determine which goods and importers represent the highest risk and should, therefore, be targeted for verification;
- a sampling methodology intended to allow national measurement of results;
- a standardized method for conducting verifications, which includes an information system to store the verification results;
- a monitoring program to follow up with importers to ensure that corrections are made and any duties and taxes are paid;
- a quality assurance review to ensure that verifications are conducted properly and consistently; and
- increased outreach to clients.

8.57 At the time of the audit, the new strategy was not yet fully implemented. At the national level, the Agency continued to rely on spreadsheets to document the results of verifications. This process did not ensure that all completed verifications were entered into the system. Thus, although the Agency was conducting preliminary analyses of verifications, identifying high-risk commodities, and documenting classification error rates, it was using an incomplete database to do so. Without complete information, the Agency cannot identify and address non-compliance effectively.

8.58 We found that properly implementing the strategy, as it was designed, may require more resources than were being devoted to it. For example, regional verification teams were unable to complete all the verifications they were assigned to do within a year, using the new sampling methodology and risk-based approach. As well, the verification work in larger companies was insufficient to determine the level of compliance within those companies, which limited the accuracy of national measurement of compliance.

8.59 **Recommendation.** To have better assurance that the assessments provided by importers are accurate and complete, the

Canada Border Services Agency should improve its measurement and monitoring of

- trend information on importer compliance,
- significant changes in compliance patterns, and
- the estimated revenue impact of non-compliance with the rules for assessing duties and taxes owing on imported commercial goods.

The Agency's response. Agreed. As noted, the Agency has planned significant changes to its current compliance activities that will result in identifying the revenue impact of non-compliance by statistically sampling at the tariff item level. The results of these verifications will be analyzed to identify long-term trends in importer compliance and will assist the Agency with its focused verification targeting, as well as help to identify specific causes of non-compliance, so that effective corrective measures may be put into place. The compliance strategy is expected to be fully implemented by 1 April 2011. By ensuring the adequate collection and analysis of both quantitative and qualitative data through the implementation of this strategy, the Agency will significantly increase its assurance that assessments provided by importers are accurate and complete.

A more consistent approach to monitoring is needed

Reassessment policy—A policy that applies at the conclusion of each compliance verification, when errors are found, and requires that importers correct their records for a period of between one and four years.

8.60 Once compliance verifications are completed, if errors are found, Agency procedures require that its **reassessment policy** be applied. Under the policy, importers are required to make corrections and pay the duties and taxes owing within 90 days. Agency procedures further require compliance verification teams to monitor such cases to ensure that importers make the necessary corrections. If importers do not make the corrections, they are subject to penalties and further monitoring.

8.61 In the 2009–10 fiscal year, by following up on 468 cases, the Agency assessed an additional $44 million in duties and taxes as a result of the monitoring process. This means that importers were not always making the required corrections and paying the additional taxes and duties owing. It also means that the monitoring identified substantial additional revenues owing.

8.62 However, the Agency does not monitor all closed cases where non-compliance was found, as required. As well, where monitoring is conducted and continued non-compliance is found, the decision on whether to conduct further monitoring is left to the compliance

verification officer. The Agency is developing a monitoring process, which includes formal criteria to guide the decision.

8.63 In addition, the Agency's 2009 compliance verification Quality Assurance Review pilot found that the reassessment policy was not being applied consistently. In 11 of the 71 verifications reviewed, the policy was not correctly applied, that is, importers in these cases were not properly instructed to correct their accounting documents and pay the additional revenues owing.

8.64 **Recommendation.** The Canada Border Services Agency should ensure that the reassessment policy is applied consistently and correctly. It should then monitor importers to ensure that they comply with the required corrective actions.

The Agency's response. Agreed. The Agency has already designed a detailed monitoring program that will facilitate the nationally consistent application of both the verification follow-up activities and the subsequent monitoring of non-compliant importer activities. This mandatory monitoring program will ensure that all of the expected self-corrections for the re-assessment period are properly filed and that any subsequent declarations remain fully compliant. The program will be implemented across the country by fall 2010. The Agency will also continue with its commitment to train regional verification officers and management on the proper application of the reassessment policy, and will include both the monitoring program and the application of the reassessment policy in its quality assurance reviews. Together, these initiatives will ensure that the requirements for monitoring compliance verifications and the application of the reassessment policy are met.

The Agency is working to modernize its revenue systems

8.65 Once the amounts due on imported commercial goods have been assessed, the Agency needs to collect them from importers. It collects almost all revenue through two month-end invoicing processes for authorized account holders: a process for members of the Customs Self Assessment program and the K84 process for the other account holders. The Agency conducted an internal audit of Customs Self Assessment payments in 2009 and of K84 payments in 2010. Both audits concluded that payments were being made appropriately.

K84—A billing statement issued by the Canada Border Services Agency on a daily and monthly basis for clients with account security.

8.66 However, over the past 10 years, numerous internal and external reviews of the Agency's revenue management and reporting systems and procedures have recognized the need for the Agency to modernize its revenue systems. At the time of the audit, the Agency used

five separate information systems to assess and collect revenue from importers. These five systems all feed the Agency's main revenue reporting system, the Revenue Ledger; however, transfers and reconciliations between the systems and the Revenue Ledger are performed manually. As a result, and as we have reported in our observations on the Public Accounts of Canada since 2006, the Agency is unable to fully reconcile the revenue information across its systems. As well, the most recent review of the Agency's revenue systems, conducted in 2009, concluded that its main system—the Customs Commercial System—was increasingly expensive to maintain, difficult to modify, and at significant risk of failure.

8.67 The existing systems also do not allow importers to make payments electronically; most importers or their brokers must deliver cheques in person to Agency offices. As a result, the Agency does not have timely information on accounts that have been paid.

8.68 The March 2010 Budget provided $185 million over five years to the Agency to modernize its revenue systems. The initial modernization efforts, which focus on improving the management of accounts receivable, are scheduled to be in place by December 2012.

Conclusion

8.69 Overall, we found that the Agency facilitates the flow of imported commercial goods. However, there are still some limitations that lead to inconsistent levels of facilitation, depending on where and when the goods enter the country. The Agency has plans and initiatives under way designed to address these limitations.

8.70 To facilitate the flow of imports, the Agency uses electronic information that is provided before goods arrive at the port of entry to conduct risk assessment and make release decisions. To minimize administrative costs to commercial clients and to minimize intervention in the movement of goods, the Agency has two initiatives to further automate and integrate the information it requires electronically from commercial clients—the eManifest project and the Single Window Initiative.

8.71 However, the Agency does not have a monitoring process in place to have reasonable assurance that the electronic information it receives during the importing process is accurate, complete, and timely. Without such assurance, the Agency cannot effectively assess

risk and collect the correct revenues owed. The Agency has plans designed to provide it with better assurance.

8.72 To minimize delays and to process goods in a transparent, predictable, and consistent manner, the Agency has investment plans to ensure that most of its major examination facilities are adequate. It is also working with other government departments to coordinate service levels for examinations, and it is taking steps to increase the predictability of examination times. The Agency has also begun to develop a service strategy to better measure, monitor, and make publicly available its performance against service standards for many of its key services.

8.73 The Agency does not have reasonable assurance that commercial clients' assessments of the duties and taxes owed are based on accurate information. Without such assurance, the Agency cannot verify that assessments are correct and it cannot be certain that it is collecting the correct revenues owed. It also risks providing other government organizations, such as Statistics Canada and the Department of Finance Canada, with inaccurate and incomplete trade and revenue information. The Agency is working on a strategy to address these gaps.

8.74 While its internal audits demonstrate that revenues assessed are paid, the Agency has recognized that its revenue systems need to be modernized. The March 2010 Budget provided $185 million over five years for this purpose. The initial modernization efforts, which focus on improving the management of accounts receivable, are scheduled to be in place by December 2012.

About the Audit

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by The Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

Objectives

The objective of the audit was to determine whether the Canada Border Services Agency's integrated border services facilitate the free flow of imported commercial goods and collect the revenues owed on those goods.

Scope and approach

This was the first performance audit looking at how the Canada Border Services Agency is fulfilling the facilitation component of its mandate since the Agency was formed in December 2003. It covered the Agency's pre-border, at-the-border, and post-border processes for the processing of imported commercial goods.

We examined

- how the Agency collects and analyzes advance information for risk assessment purposes;
- how the Agency assesses the adequacy of examination facilities;
- whether the Agency has developed service standards;
- whether the Agency tracks performance against those standards to improve border services; and
- what mechanisms the Agency uses to collect accurate and complete accounting information, as well as the systems and practices it needs to collect appropriate duties, taxes, and penalties.

Our audit work consisted primarily of interviews, document reviews, process and system walk-throughs, as well as site visits to the Agency's major commercial operations in five regions. We verified the methodologies, working papers, and statistics that support the studies, internal audits, and evaluations cited in this report, to determine whether we could rely on the work. For the internal audits and evaluations, we also assessed the qualifications of the teams conducting the work. We concluded that we could rely on these analyses for the purposes of this audit.

We did not examine the Agency's responsibilities and activities related to

- unlawful and non-commercial goods being imported or exported;
- commercial goods being imported or exported by post;
- goods in transit or temporary admission of vessels for coastal trade; or
- the entry, detention, or removal of travellers.

Criteria

To determine whether the Canada Border Services Agency's integrated border services facilitate the free flow of imported commercial goods and collect the revenues owed on those goods, we used the following criteria:

Criteria	Sources
The Canada Border Services Agency has service standards for the assessment of commercial information that • reflect client needs (client opinions, expectations, priorities, and preferences); • are communicated to clients; • are measured regularly to identify service quality issues; and • are acted on to improve service.	• *Canada Border Services Agency Act*, section 5 • *Customs Act*, sections 8, 12, and 107 • Results for Canadians—A Management Framework for the Government of Canada, Treasury Board, 2000 • A Policy Framework for Service Improvement in the Government of Canada, Treasury Board, 2000 • Integrated Risk Management Framework, Treasury Board, 2001, Element 3 • Communication Policy of the Government of Canada, Treasury Board, Policy Statement 1 • D-Memorandum D17-1-4 (Release of Commercial Goods), Canada Border Services Agency, sections 3, 4, 59, and 60, and Appendix B • International Convention on the Simplification and Harmonization of Customs Procedures, World Customs Organization, General Annex, sections 3.18, 3.25, 6.3, 7.1, and 7.4
The Agency requests only the commercial information that it needs to assess commercial goods prior to their arrival at the border, on the basis of identified risks.	• *Customs Act*, sections 7, 8, and 12. • D-Memorandum D17-1-4 (Release of Commercial Goods), Canada Border Services Agency, sections 5, 6, 30, 46, 52, and 53 • D-Memorandum D3-1-7 (CSA Program for Carriers), Canada Border Services Agency, section 1 • International Convention on the Simplification and Harmonization of Customs Procedures, World Customs Organization, General Annex, section 3.12
At its ports of entry, the Agency provides timely and consistent border services for imported commercial goods.	• *Canada Border Services Agency Act*, section 5 • *Customs Act*, section 101 • Results for Canadians, Treasury Board, 2000 • Policy Framework for Service Improvement in the Government of Canada, Treasury Board, 2000 • Integrated Risk Management Framework, Treasury Board, 2001, Element 3 • D-Memorandum D1-2-1 (Special Services), Canada Border Services Agency, sections 1 to 11 • Report on Plans and Priorities (RPP), Canada Border Services Agency, 2009–10, Client Service

To determine whether the Canada Border Services Agency's integrated border services facilitate the free flow of imported commercial goods and collect the revenues owed on those goods, we used the following criteria:	
Criteria	**Sources**
	• RPP, Canada Border Services Agency, 2009–10, Program Activity—Facilitated Border • International Convention on the Simplification and Harmonization of Customs Procedures, World Customs Organization, General Annex, sections 3.1 and 3.35 and sections 6.2 to 6.5
The Agency's asset management and investment plans provide for facilities for the timely, consistent, and risk-based examination of imported and in-bond commercial goods.	• *Canada Border Services Agency Act*, section 5(d) • *Customs Act*, sections 5 and 6 • Policy Framework for the Management of Assets and Acquired Services, Treasury Board, 2006
The Agency has systems and practices in place to collect accurate and complete information from importers to account for their imported commercial goods.	• *Customs Act*, sections 7, 32, and 42 • Integrated Risk Management Framework 2001, Treasury Board, 2001, Element 3
The Agency has systems and practices in place to collect the duties, taxes, and penalties it is owed from commercial importers.	• *Customs Act*, sections 32, 33, 42, 109, 124, and 127 • *Accounting for Imported Goods and Payment of Duties Regulations*, sections 3, 4, and 6

Management reviewed and accepted the suitability of the criteria used in the audit.

Period covered by the audit

This audit covered the period between April 2008 and May 2010. However, some documents reviewed go back to 2005. Audit work for this chapter was substantially completed on 31 May 2010.

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Appendix List of recommendations

The following is a list of recommendations found in Chapter 8. The number in front of the recommendation indicates the paragraph where it appears in the chapter. The numbers in parentheses indicate the paragraphs where the topic is discussed.

Recommendation	Response
Facilitating commercial shipments	
8.28 The Canada Border Services Agency should improve its systems and practices for monitoring the quality of electronic information that it receives during the commercial importing process—to obtain reasonable assurance that this information is accurate, complete, and timely. The Agency should then use the results of its monitoring process for continuous improvement. (8.24–8.27)	Agreed. As the Auditor General has acknowledged, the Agency has begun to address possible gaps in the commercial import process, in part, through the development of the Commercial Programs Compliance Plan, a pilot project that will be initiated in spring 2011 with full implementation in 2012. The Agency is also enhancing monitoring of commercial import process data transmission requirements and is developing a comprehensive monitoring framework as part of the eManifest project. These compliance monitoring processes will be put in place in fall 2010 to support the initial implementation of eManifest in the highway mode. By 2014, systems will be in place to enable the Agency to assess risk and compare commercial information from the pre-arrival through to the post-release phases of the import process. Legislative and regulatory changes related to eManifest will prescribe that specific parties within the trade chain will be held liable for the accuracy and timeliness of this information. The Administrative Monetary Penalty System (AMPS) program is another tool that the Agency uses to encourage importers and exporters to comply with trade laws and regulations, as well as laws it enforces on behalf of other government departments. The program includes penalties for inaccurate, incomplete, and untimely transmission of trade data. The Agency will further develop the AMPS program to provide compliance support for new initiatives, such as the eManifest project, as each phase of the project is implemented. Taken together, these initiatives will ensure that the electronic information received from clients is increasingly accurate, complete, and timely.

Recommendation	Response
8.49 The Canada Border Services Agency should improve its measurement of service standards and should collect and publish service information to increase predictability in the commercial importing process. (8.38–8.48)	Agreed. The Agency has undertaken a three-year service improvement strategy that will strengthen the Agency's commitment to service, enhance the service culture, and simplify and streamline how the Agency and clients interact. One goal of the strategy is to set targets and to measure and publish service standards, ultimately improving predictability for commercial clients and resulting in continued service improvements. External stakeholder input on priorities and recommendations with respect to this initiative is being sought through the Border Commercial Consultative Committee's sub-committees on wait times, examinations, and service standards. As service standards are identified, they will be progressively implemented starting in January 2011. Under its service strategy initiative, the Agency is developing an inventory of service standards and external services that identifies tasks, outputs, and clients. To guide the consistent development of future service standards and performance measures, the Agency is developing a comprehensive training package; delivery to staff will begin by fall 2010. This will enable specific service line owners to develop new service standards for their programs.
Assessing and collecting duties and taxes	
8.59 To have better assurance that the assessments provided by importers are accurate and complete, the Canada Border Services Agency should improve its measurement and monitoring of • trend information on importer compliance, • significant changes in compliance patterns, and • the estimated revenue impact of non-compliance with the rules for assessing duties and taxes owing on imported commercial goods. (8.50–8.58)	Agreed. As noted, the Agency has planned significant changes to its current compliance activities that will result in identifying the revenue impact of non-compliance by statistically sampling at the tariff item level. The results of these verifications will be analyzed to identify long-term trends in importer compliance and will assist the Agency with its focused verification targeting, as well as help to identify specific causes of non-compliance, so that effective corrective measures may be put into place. The compliance strategy is expected to be fully implemented by 1 April 2011. By ensuring the adequate collection and analysis of both quantitative and qualitative data through the implementation of this strategy, the Agency will significantly increase its assurance that assessments provided by importers are accurate and complete.

Recommendation	Response
8.64 The Canada Border Services Agency should ensure that the reassessment policy is applied consistently and correctly. It should then monitor importers to ensure that they comply with the required corrective actions. **(8.60–8.63)**	Agreed. The Agency has already designed a detailed monitoring program that will facilitate the nationally consistent application of both the verification follow-up activities and the subsequent monitoring of non-compliant importer activities. This mandatory monitoring program will ensure that all of the expected self-corrections for the re-assessment period are properly filed and that any subsequent declarations remain fully compliant. The program will be implemented across the country by fall 2010. The Agency will also continue with its commitment to train regional verification officers and management on the proper application of the reassessment policy, and will include both the monitoring program and the application of the reassessment policy in its quality assurance reviews. Together, these initiatives will ensure that the requirements for monitoring compliance verifications and the application of the reassessment policy are met.

Report of the Auditor General of Canada to the House of Commons—Fall 2010

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to the House of Commons

Chapter 9

Animal Diseases—Canadian Food Inspection Agency

Office of the Auditor General of Canada



2010



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FALL

Chapter 9

Animal Diseases—Canadian Food Inspection Agency

Office of the Auditor General of Canada

The Fall 2010 Report of the Auditor General of Canada comprises Matters of Special Importance, Main Points—Chapters 1 to 9, Appendices, and nine chapters. The main table of contents for the Report is found at the end of this publication.

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Chapter

9

Animal Diseases—Canadian Food Inspection Agency

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Animal Diseases—Canadian Food Inspection Agency

Main Points

What we examined

The Canadian Food Inspection Agency monitors the international progression of animal diseases, controls animal imports, and responds to animal diseases when they are detected in Canada. Working with industry, the provinces, and other federal departments, the Agency delivers a number of programs and services designed to protect Canada's animal resource base. About $200 million annually—30 percent of its budget—is allocated to animal health programs.

Among these animal health programs, we examined the Agency's state of preparedness for animal disease emergencies—situations that call for prompt action outside of normal activities. We also looked at how the Agency managed recent animal disease emergencies.

Audit work for this chapter was substantially completed on 30 April 2010.

Why it's important

Trends in animal disease indicate that new diseases are emerging and more virulent forms of existing diseases, such as tuberculosis, are on the increase. Certain animal diseases, such as avian influenza, also threaten human health. Foreign animal diseases are of particular concern as many such diseases could enter Canada because of international trade and travel.

Failure to prevent the spread of animal diseases, including those that can be spread to humans, could cost Canada's livestock industry billions of dollars in lost production, the loss of international markets through export embargoes, and the costs of control and response activities.

What we found

- The Agency has developed a collection of documents to guide its response to animal disease emergencies. These include its overall emergency response plan, the animal health functional plan that provides a framework for responding to animal diseases, and hazard-specific plans for avian influenza and foot-and-mouth disease. These plans are consistent with accepted emergency management standards.

- Some important work to improve readiness is not assigned deadlines or tracked until complete. The Agency has identified the need to update disease specific plans and develop procedures for certain higher risk animal diseases. However, it has not identified priorities or established a work plan to complete this work. This means that important work may not be completed on a timely basis, which could impact the Agency's emergency readiness. While the Agency has invested considerable effort in developing emergency preparedness and response strategies, key challenges remain. For example, the Agency has significant work to do to enhance readiness for foot-and-mouth disease.
- The Agency has a wide range of activities to enable it to derive lessons from animal disease emergencies and training exercises. However, it lacks a systematic approach to ensure that all key lessons are compiled, tracked, and acted upon. As a result, similar issues continue to be identified over the years. If these issues are not addressed, the Agency's response to an emergency could be affected.
- The Agency followed its established plans and procedures in managing the response to the avian influenza outbreaks of 2007 in Saskatchewan and 2009 in British Columbia. However, each disease and each outbreak is unique, and these results cannot be generalized to predict the Agency's response to future outbreaks.

The Agency has responded. The Agency agrees with all of the recommendations. Its detailed responses follow the recommendations throughout the chapter.

Introduction

Managing animal diseases

9.1 The mandate of the Canadian Food Inspection Agency is to safeguard Canada's food supply and protect the animals and plants upon which safe, high-quality food depends. It is the largest science-based regulatory agency in Canada, and it is responsible for delivering federally mandated food inspection, plant protection, and animal health programs. The Agency, which reports to the Minister of Agriculture and Agri-Food, employs about 6,500 people across Canada. It administers 13 federal statutes and 38 related regulations.

9.2 In the 2008–09 fiscal year, the Agency spent about $200 million—30 percent of its total spending—to protect Canada's animal resource base (which includes livestock and aquatic species), to protect Canadians from **zoonotic diseases**, and to protect the Canadian economy from the effects of an outbreak of animal disease.

Zoonotic disease—A disease that can be transmitted from animals to humans.

9.3 Serious outbreaks of animal diseases can cause Canada's border to be closed to animal exports, including animal products and by-products. Protecting the animal resource base is important for ensuring the Canadian food supply and for the well-being of all Canadians.

9.4 Working with industry, the provinces, and other federal departments, the Agency delivers a number of programs and services that are designed to protect the health of Canadians and Canada's animal resource base. Key activities include

- watching for and controlling disease,
- working with international partners to set standards,
- verifying that exports of animals and animal products meet foreign requirements, and
- verifying that imports of animals and animal products meet Canadian requirements.

9.5 Trends in animal disease show that new diseases are emerging and that more harmful forms of existing diseases, such as tuberculosis, are increasing. As international cases have shown, an outbreak of foot-and-mouth disease could have serious results. Some zoonotic diseases, such as avian influenza (bird flu), have become major concerns in recent years because they threaten Canada's agricultural economy, as well as human and animal health, and because they could halt exports. Further information on these diseases is provided in Exhibit 9.1.

9.6 The Agency's authority to manage animal diseases comes from the federal *Health of Animals Act*. The purpose of the Act is to prevent certain communicable animal diseases from being introduced and spread in Canada. The associated *Reportable Diseases Regulations* list a number of reportable diseases; the Act and regulations require animal owners, veterinarians, and laboratories to promptly report any suspected or confirmed cases to the Agency.

Exhibit 9.1 Avian influenza and foot-and-mouth disease are two diseases of concern

Avian influenza

Avian influenza is a contagious viral infection caused by the influenza virus Type A. This virus can infect a variety of species: wild birds, domestic birds, and mammals, including humans. Based on how severely the illness affects birds, avian influenza is classified as either low pathogenic or high pathogenic. Symptoms of avian influenza in domestic birds range from mild respiratory illness to reduced egg production to death. Avian influenza can cross over to other species, including humans. Scientists think that this movement between species increases the risk of influenza pandemics in humans.

Avian influenza is found in wild bird populations. The Agency believes that the Canadian cases to date are likely the result of the virus being transmitted from wild birds to domestic ones. The outbreaks in 2009 in the Lower Mainland of British Columbia and in 2007 in southern Saskatchewan were found on the migration routes of waterfowl.

In Canada, all cases or suspected cases of pathogenic avian influenza must be reported to the Canadian Food Inspection Agency immediately.

Foot-and-mouth disease

Foot-and-mouth disease is a severe, highly communicable viral disease. It can infect a number of species, such as cattle, swine, sheep, goats, deer, and other ruminants (animals that chew their cud) that have cloven hoofs. It is easily transmitted by direct contact (where an infected animal comes into contact with other animals directly) or by indirect contact (where susceptible animals are exposed to the virus on clothes, footwear, equipment, and materials or are fed contaminated feed or water). The virus can also be transmitted through airborne particles, which allow the disease to spread over long distances. If an outbreak of foot-and-mouth disease happens, the virus could spread quickly to all parts of Canada through routine livestock movements.

An outbreak of foot-and-mouth disease could have a serious impact on the livestock industries in an infected country and could lead to international trade restrictions against animals and animal products from that country. The risk that foot-and-mouth disease poses is great, as was proven during the 2001 outbreak in the United Kingdom, where around 700,000 of 9 million cattle were **depopulated**. In comparison, on 1 January 2010, Canada had some 13 million cattle, many of which were concentrated in certain areas of the country. For example, on that date, there were about 5 million cattle in the Province of Alberta. Although Canada had an outbreak of this disease in 1952, it is considered to be free of it now. Foot-and-mouth disease is a reportable disease under the *Reportable Diseases Regulations*. All cases or suspected cases must be reported to the Canadian Food Inspection Agency immediately.

Depopulate—To remove all animals from a particular environment.

Sources: Adapted from:
Canadian Food Inspection Agency documents

National Audit Office: The 2001 Outbreak of Foot and Mouth Disease, Report by the Comptroller and Auditor General, HC 939 Session 2001–2002: 21 June 2002.

Statistics Canada, February 2010, Cattle Statistics 2010, Catalogue no. 23-012-X, vol. 9, no. 1, as of 1 January 2010, pages 7 and 19.

9.7 Reportable diseases include foreign animal diseases that have not yet been found in Canada and diseases that have been found in Canada. As a first line of defence against foreign animal diseases, the Agency monitors the progression of diseases internationally and controls animal imports to reduce the risk of these diseases entering the country. When a foreign animal disease, such as high pathogenic avian influenza, is found in Canada, the Agency treats the situation as an emergency and, with its partners, works to stamp out the disease quickly. The Agency has ongoing control programs in place for reportable diseases that have been found in Canada, such as anthrax, tuberculosis, and chronic wasting disease. To encourage people to report suspected reportable diseases right away, the Agency runs a program to compensate animal producers financially when disease strikes.

9.8 The Agency also has international obligations to report certain animal diseases that are found in Canada. If a serious animal disease is found in Canada, international trading partners may ban Canadian exports.

Animal disease emergencies since 2004

9.9 Animal disease emergencies have been happening more often in recent years. The Agency expects this trend to continue because international trade and travel is growing and new diseases are emerging. Since 2004, the Agency has managed five animal disease emergencies (Exhibit 9.2).

9.10 Avian influenza poses a major threat to animal and public health. The 2004 outbreak of avian influenza was the first reported case of high pathogenic avian influenza in domestic poultry in Canada. To control the spread of the disease, over 13 million domestic birds had to be depopulated. This was the first large-scale animal disease

Exhibit 9.2 The Canadian Food Inspection Agency has managed five animal disease emergencies since 2004

Date	Disease	Location
2009	Low pathogenic avian influenza	Lower Mainland, British Columbia
2007	High pathogenic avian influenza	Southern Saskatchewan
2005	Low pathogenic avian influenza	Lower Mainland, British Columbia
2005	Bovine spongiform encephalopathy (BSE, or mad cow disease)	Alberta
2004	High pathogenic avian influenza	Lower Mainland, British Columbia

Source: Adapted from Canadian Food Inspection Agency documents

emergency since an outbreak of foot-and-mouth disease in 1952. After the 2004 outbreak, several organizations, including the Agency and the Standing Committee on Agriculture and Agri-Food, prepared reports that named a number of weaknesses in the Agency's response. Some of the key weaknesses mentioned in these reports were

- a lack of up-to-date emergency response plans and procedures to deal with animal disease emergencies, including agreements with key partners such as the provinces;
- inadequate testing of plans and procedures; and
- poor communication within the Agency and between the Agency and its key partners.

Federal responsibility for emergency preparedness

9.11 Recent events linked to threats of natural disasters, disease outbreaks, and terrorism have made people more aware of the importance of emergency preparedness. Canada's emergency management framework is based on the premise that the initial responsibility for an emergency rests with those who are directly affected. Responsibility then moves through the levels of government, as needed, from municipal to provincial to federal. The federal government gets involved only when an emergency clearly falls under the mandate of a certain department or agency, when a province or territory asks for help, or when an emergency situation could affect the national interest and thus calls for a centralized response from the Government of Canada.

9.12 In August 2007, the *Emergency Management Act* came into effect. The Act gives the Minister of Public Safety the responsibility of providing emergency management leadership, which involves coordinating federal emergency management activities. Section 6(1) of the Act gives ministers the responsibility of preparing for emergencies that fall within their mandates (these are often described as "mandated emergencies"):

> The emergency management responsibilities of each minister accountable to Parliament for a government institution are to identify the risks that are within or related to his or her area of responsibility—including those related to critical infrastructure—and to do the following in accordance with the policies, programs and other measures established by the Minister [of Public Safety]:
>
> (a) prepare emergency management plans in respect of those risks;

(b) maintain, test and implement those plans; and

(c) conduct exercises and training in relation to those plans.

9.13 The Agency's mandate includes dealing with emergencies that involve food safety, animal health, plant health, and any other situation linked to Agency responsibilities. It manages most situations with existing programs. For example, it has programs for managing animal diseases that have already been found in Canada, such as tuberculosis and chronic wasting disease. For situations where the response needed is greater than can be accomplished using the Agency's existing programs, the Agency's President declares an emergency, so additional authorities can be used to manage the incident.

Focus of the audit

9.14 Our audit focused on one aspect of the Canadian Food Inspection Agency's efforts to protect Canada's animal resource base: The Agency's efforts to prepare for animal disease emergencies in domestic livestock and its response to the two most recent disease emergencies—the outbreaks of avian influenza in 2007 and 2009.

9.15 Specifically, we examined whether the Agency had planned for, responded to, and learned from animal disease emergencies in ways that were consistent with the *Emergency Management Act* and with emergency management standards.

9.16 We did not examine animal disease surveillance, animal imports and exports, or the payment of compensation to producers.

9.17 More details about the audit objectives, scope, approach, and criteria are in **About the Audit** at the end of this chapter.

Observations and Recommendations

Preparing for animal disease emergencies

9.18 The 2004 avian influenza emergency was difficult for the Canadian Food Inspection Agency. Some 13 million birds in the Lower Mainland of British Columbia were depopulated, and many parties, including the House of Commons Standing Committee on Agriculture and Agri-Food, criticized the Agency's response. We observed that after the 2004 outbreak of avian influenza, the Agency noted that it needed to improve its emergency planning and preparedness so that future responses would be more effective. As a result, many of the procedures and activities we reviewed during our audit were put in place after 2004.

9.19 Emergency preparedness is a key element of emergency management that involves creating effective policies, procedures, and plans for managing emergencies when they occur. Preparing for an emergency can help prevent delays and confusion during the actual emergency response.

9.20 We assessed the Agency's preparations for animal disease emergencies against standards in legislation and against national standards. Section 6(1) of the *Emergency Management Act* requires departments and agencies to fulfill their emergency management responsibilities as outlined in the policies, programs, and other measures established by the Minister of Public Safety. During our audit, in March 2010, Public Safety Canada announced the Federal Policy for Emergency Management and the Federal Emergency Response Plan. The policy applies to all federal institutions and gives departments and agencies direction as they prepare emergency management plans that are specific to their mandate. Because the policy had not been published when we started this audit, we assessed the Agency's plans against expectations set out in a national standard for emergency management plans: The Canadian Standards Association Standard Z1600-08—Emergency management and business continuity programs (2008).

9.21 We examined the following elements of emergency preparedness, based on the *Emergency Management Act* and Canadian emergency management standards:

- assessing risks related to animal disease emergencies;
- preparing emergency management policies, plans, and procedures to address identified risks; and
- conducting exercises and training related to policies, plans, and procedures.

The Agency has assessed animal disease risks

9.22 Assessing the risks that animal diseases pose is an essential step in emergency management. In this way, appropriate steps for preventing, reducing, and preparing for emergencies can be created based on the level of risk. Risk assessment offers information about what the impact on the environment, the economy, and an organization is likely to be, and makes it easier to provide rapid emergency responses, based on acceptable risk tolerance levels. The *Emergency Management Act* requires that departments and agencies

identify the risks related to their areas of responsibility. We examined whether the Agency assessed animal disease risks.

9.23 We observed that the Agency assesses risks related to animal diseases in a number of ways, including

- high-level assessments of corporate risks,
- identification and regulation of high-risk animal diseases, and
- detailed assessments of the risks posed by a specific disease or by the importing of an animal or of animal products into Canada.

9.24 Agency-wide risks. The Agency completed a corporate risk profile in 2008 that identified and ranked nine key risks that could reduce the Agency's ability to achieve its objectives. The introduction and spread of animal diseases, including animal diseases that can spread to humans, were ranked second and third among those nine risks. (Risks associated with hazards in food were ranked first.)

9.25 Assessment of high-risk diseases. The *Reportable Diseases Regulations* name the diseases that are reportable (paragraph 9.6). The Agency states that these diseases are "usually of significant importance to human or animal health or to the Canadian economy." The Agency periodically updates the list in the regulations to ensure that it reflects the current assessment of what constitutes a disease of significant importance. For example, we noted that the Agency last updated the *Reportable Diseases Regulations* in April 2010 to remove certain types of the bluetongue virus from the reportable disease list.

9.26 Technical risk assessments. The Animal Health Risk Assessment (AHRA) unit in the Agency's Science Branch is responsible for completing risk assessments and providing science advice. Most risk assessments are done to respond to requests from other branches. Branches need the information to make decisions about importing animals or managing an existing disease.

9.27 We found that the Agency has a consistent approach to conducting risk assessments using the Animal Health and Production Risk Analysis framework, which is based on standards developed by the World Organization for Animal Health. Between 2007 and 2009, AHRA produced 46 risk assessments. These assessments related to animal imports and exports as well as to animal diseases, such as bluetongue, avian influenza, and foot-and-mouth disease. AHRA does not have a backlog of assessments.

The Agency has developed policies, plans, and procedures to manage animal disease emergencies, but some are not complete

9.28 Documented emergency policies, plans, and procedures are essential elements of emergency preparedness. We examined whether the Agency had developed emergency management policies, plans, and procedures to manage animal disease emergencies in accordance with the *Emergency Management Act* and emergency management standards.

9.29 The Agency has a collection of documents that guide its response to animal disease emergencies. This guidance has a hierarchy, where the emergency response plan applies to all emergencies in the Agency, and other documents focus on health issues in animals, including emergencies, in increasing detail (Exhibit 9.3).

9.30 We found that the Agency has made considerable efforts to develop and amend its emergency response policies, plans, and procedures for animal diseases. Together, these documents guide the Agency's response to animal disease emergencies at a level of detail that is consistent with emergency management standards. We also found examples of important work to improve readiness to respond to animal disease emergencies not being given a deadline and not being tracked until it is complete. If deadlines are not set and work is not tracked to completion, the Agency cannot be sure that important readiness work is being completed in a timely way.

9.31 Emergency policies, plans, and procedures need to be regularly maintained to deal with new scientific knowledge and include the experience gained from testing the plans and managing emergencies. Since 2004, the Agency has approved and amended policies, plans, and procedures (Exhibit 9.3). We observed several examples of Agency officials using the findings of **lessons learned** reports to update the plans they are responsible for managing. However, further work is needed to update hazard-specific plans and procedures.

Lessons learned—Reports that capture the results of an event, such as emergency or exercise, in a manner that allows for improvements in the future.

9.32 As we note later in this chapter (paragraph 9.61), the Agency does not have a systematic approach for identifying and resolving the key issues identified in its lessons learned reports, which it completes after an outbreak or training event. This reduces the Agency's ability to ensure that it identifies the most important needs for new or amended policies, plans, or procedures and its ability to track them until they are dealt with.

9.33 Transition to hazard-specific plans. Agency officials noted that before the 2004 avian influenza emergency, the Agency had a range of plans to address specific animal diseases. The Agency gave us 18 of these plans, which were dated between 1996 and 2003. We observed that the Agency has noted the need to update older plans for specific diseases. The Agency refers to the updated plans as hazard-specific plans.

Exhibit 9.3 The Canadian Food Inspection Agency has developed plans and procedures to deal with animal disease emergencies

Document title	Description	Status
Canadian Food Inspection Agency Emergency Response Plan	Describes roles and responsibilities, operational framework, and emergency response process for the Agency as a whole.	Approved in 2005 and amended in 2009
Animal Health Functional Plan	Outlines responsibilities, tasks, and actions related to animal health incidents, including animal disease emergencies.	Approved in 2006 and currently under revision
• Strategies (older format) • Hazard Specific Plans (newer format)	Provides additional guidance for responding to specific animal diseases.	Strategies have been developed for 18 higher risk diseases, including Classical Swine Fever and Vesicular Stomatitis. • These older format strategies were developed between 1996 and 2003. • The Agency plans to update strategies to the Hazard Specific Plan format. Two Hazard Specific Plans have been developed and approved: • Notifiable Avian Influenza Hazard Specific Plan—approved in 2006 and currently under revision • Foot-and-Mouth Disease Hazard Specific Plan—approved in 2007 and has not been updated
Common Procedures Manual	Provides instructions for a specific task related to an animal disease incident. Depending on the nature of the procedure, it could apply to one or more animal diseases.	Common Procedures Manual approved in 2004, which includes procedures for • disposal • treatment • cleaning and disinfection Draft procedures for avian influenza have been developed and are awaiting approval, such as • Burial Procedure Plan • Poultry Incineration Procedure

Source: Adapted from Canadian Food Inspection Agency documents

9.34 Its officials told us that the Agency sees avian influenza and foot-and-mouth disease as the biggest threats to Canada's animal resource base today: avian influenza because of four emergencies since 2004, and foot-and-mouth disease because of the damage it has done to livestock and the economy in other countries. In 2007, the Agency finalized two hazard-specific plans: one for avian influenza and one for foot-and-mouth disease. By preparing these plans first, before updating the older strategies for specific diseases, the Agency has covered the two diseases that they told us posed the highest risk.

9.35 Deciding which disease strategies need to be updated to hazard-specific plans should be based on risk; such updates may not be necessary for all animal disease threats. We asked about the Agency's intentions to complete hazard-specific plans for other animal diseases, including diseases that are addressed by other strategies. We found that the Agency plans to complete four hazard-specific plans in the 2010–11 fiscal year. However, it has not yet decided which other strategies need to be converted to hazard-specific plans or when this conversion would happen.

9.36 **Updating the Common Procedures Manual.** The Agency's Common Procedures Manual (2004) provides instructions for specific tasks related to an animal disease incident. The Agency has identified the need to create new procedures and update existing ones for higher-risk diseases, such as avian influenza and foot-and-mouth disease.

9.37 We observed that, since 2006, the Agency has focused its efforts on creating more procedures based on its experiences with avian influenza. Thirteen new procedures are nearing completion but have not been formally approved. We found that, in the meantime, Agency officials applied the draft procedures to animal disease emergencies. For example, during the 2009 outbreak of avian influenza, the Agency disposed of slaughtered poultry, using a method outlined in a draft procedure. While the Agency has identified the need to develop procedures for other animal diseases, it has not identified priorities or created a work plan to complete this work, which could affect its emergency readiness.

9.38 **Improving readiness.** Taking steps to improve readiness for future animal disease emergencies is a regular part of the Agency's operations. Being ready to respond to emergencies also includes creating risk-based action plans for known issues. For example, the Agency currently identifies almost 100 risks linked to foot-and-mouth

disease. These risks include a lack of resources to carry out large-scale depopulation and disposal of animals and a lack of precise data on animals, such as the exact number and location of livestock. The Agency has developed an action plan with over 100 deliverables to address these risks, and it monitors this plan regularly.

9.39 Since 2004, the Agency has developed and updated its policies, plans and procedures to be better prepared for animal disease emergencies. However, it has not yet set priorities and developed work plans for completing hazard-specific plans or procedures for those diseases it believes to be of higher risk than others. If the Agency does not set priorities for completing hazard-specific plans and detailed procedures for higher risk diseases, important work may not be completed on time, which could have an impact on the Agency's emergency readiness.

9.40 Recommendation. The Canadian Food Inspection Agency should set priorities, based on risk, for completing hazard-specific plans and procedures for dealing with higher risk diseases. Based on these priorities, it should schedule the work and monitor the status of this work.

The Agency's response. Agreed. The Agency has recently reviewed the status of all hazard-specific plans and has prioritized them based on risk. Procedural documents that underpin the hazard-specific plans for higher risk diseases will be prioritized for development and completion based on risk. An action plan will be developed that identifies work plans and timelines for completing identified hazard-specific plans and procedures. The action plan will be monitored and progress will be reported through the Agency's policy and programs governance structure.

The Agency carries out training and exercises

9.41 Another essential element of being prepared to deal with an emergency is training staff to respond. The *Emergency Management Act* requires the Agency to conduct training and exercises for emergencies that are related to its mandate. We examined whether the Agency carried out training and exercises related to animal disease emergencies. We found that the Agency delivers training and exercises related to the Animal Health Program and emergency management and tracks the delivery of both. We did not audit the quality of the Agency's training or exercises.

9.42 The Agency has a training curriculum for the animal health program that it updates regularly. Training covers a wide variety of topics, including

- the identification of foreign animal diseases;
- Agency policies, plans, and procedures related to animal diseases; and
- the **Incident Command Structure**.

Incident Command Structure—A combination of facilities, equipment, personnel, procedures, and communications that operate in a temporary organizational structure that is designed to assist with an emergency response.

9.43 We noted that the Agency has systems in place to track what kind of training individual staff members receive. Recent training has included

- a logistics exercise involving access to an international stockpile of veterinary medicines and protocols around a multi-state partnership to deal with foot-and-mouth disease;
- a meeting and training session for the Animal Health Emergency Response Team for the Quebec area; and
- an exercise, in Ontario, that dealt with an outbreak of a foreign animal disease in large animals.

9.44 We examined whether the Agency had analyzed the results of exercises to consider lessons learned. We selected a poultry exercise from Saskatchewan and confirmed that a report on lessons learned during the exercise had been prepared. The Agency's ability to benefit from lessons learned from a wide variety of sources is discussed later in this chapter (paragraph 9.56).

Responding to avian influenza emergencies

9.45 Four of the five animal disease emergencies the Canadian Food Inspection Agency has faced since 2004 were outbreaks of avian influenza in western Canada (Exhibit 9.2). We examined how the Agency responded to the two most recent emergencies (Saskatchewan, in 2007, and British Columbia, in 2009) to see whether it followed the policies, plans, and procedures it had put in place. We selected these emergencies to see how the Agency responded to recent cases, rather than to those that were several years old.

9.46 Each animal disease emergency is unique. While the two we examined had some similarities, they also had some differences. Both involved avian influenza in domestic bird flocks, but the 2007 emergency involved the high pathogenic variety, and the 2009 emergency involved the low pathogenic variety. Also, the 2007 outbreak in Saskatchewan was in a rural area that had relatively few people or domestic birds nearby. The 2009 outbreak, however, was in

the Lower Mainland of British Columbia in an area with much higher concentrations of domestic flocks and people, which increased the risk that the outbreak would spread. Since each outbreak is unique, the Agency's guidance is designed to meet the needs of different situations.

9.47 We examined whether the Agency managed these emergencies according to its own policies, plans, and procedures for dealing with animal disease emergencies (Exhibit 9.3). We focused on the Agency's own emergency response activities, not on the actions of its key partners or stakeholders, such as the provinces, industry groups, and owners and operators of the infected premises; and not on the actions of those on nearby premises that could become infected.

9.48 As outlined in the Agency's 2006 Notifiable Avian Influenza Hazard Specific Plan (NAIHSP), managing an avian influenza emergency involves a number of steps (Exhibit 9.4). We tested whether the Agency had followed key steps in its response to the 2007 and 2009 outbreaks of avian influenza. Where the Agency's 2004 Common Procedures Manual expands on the requirements of the NAIHSP, we tested whether the Agency had followed these steps as well.

Exhibit 9.4 There are a number of steps involved in managing an avian influenza emergency

Responding to reports of symptoms of an outbreak

- Performing initial tests to detect avian influenza
- Performing second tests to confirm avian influenza
- Declaring an emergency
- Communicating and working with stakeholders on an ongoing basis once an emergency is declared
- Establishing bio-security and movement controls, to reduce the risk of the outbreak spreading
- Putting in place an Incident Command Structure to provide a clear understanding of roles and responsibilities
- Activating **emergency operations centres** in one or more Agency offices
- Deploying the following to the site of the emergency:
  - people
  - non-specialized equipment, such as trailers, tents, and heavy machinery
  - specialized equipment, such as hazardous materials suits and respirators
- Depopulating animals
- Disposing of infected animals
- Approving repopulation of the premises after the operator of the infected premises has completed disinfection to Agency standards.

Source: Adapted from the Notifiable Avian Influenza Hazard Specific Plan, Canadian Food Inspection Agency, 2007

Emergency operations centre—A location at a Canadian Food Inspection Agency facility from which emergency response team members coordinate, monitor, and direct response activities

The Agency followed its own processes to manage the 2007 and 2009 avian influenza emergencies

9.49 For the 2007 and 2009 outbreaks of avian influenza, we chose 34 procedures from the Agency's 2006 NAIHSP to find out whether the Agency followed its approved plans and procedures to manage the various aspects of the outbreaks during its entire involvement. The procedures we chose covered all phases of the emergency, from the Agency's initial response to its approval of the owner/operator's request to repopulate the facility after it was decontaminated. Where the procedures contained in the Agency's Common Procedures Manual (2004) applied, we also assessed how the Agency met these more detailed expectations.

9.50 We found that the Agency managed the 2007 and 2009 avian influenza emergencies according to its own policies, plans, and procedures. In some cases, Agency officials used new procedures that were in draft form instead of using approved procedures that were out of date. The development of new procedures was discussed earlier in the chapter (paragraph 9.36).

9.51 Using multiple computer systems to record information on animal disease emergencies. The Agency's 2004 lessons learned report on the outbreak of avian influenza in British Columbia and later reports on other outbreaks have identified the need to improve information management and information technology capabilities (paragraph 9.62). For example, in 2004, the Agency identified the need for an integrated information management system to capture, in one application, all information required to manage an emergency, such as field data, laboratory results, and Geographical Information System maps.

9.52 Since 2004, the Agency has used a tool called the Canadian Emergency Management Response System (CEMRS), which was designed to handle information and manage operations during an animal disease emergency. Because CEMRS has limitations, the Agency had originally planned to replace it in 2008. However, it subsequently decided to upgrade CEMRS instead.

9.53 Agency officials told us that a priority for improving CEMRS is to better integrate, into a single application, all information that is required to manage an emergency—the same need was identified in 2004. We observed that documents for emergency management (for example, premises investigation forms and surveillance and epidemiological reports) were stored in CEMRS and other systems. Agency officials also told us that, instead of being used (as intended)

as a real-time system to manage operations during an emergency, CEMRS is used more as a historical record; officials have to keep separate records for their day-to-day use during emergencies.

9.54 Even if the Agency wishes to combine, into one information system, all information that is required to manage an emergency, officials told us that the Agency was not in a position to start funding this project this year. They also said that CEMRS is one of many operational systems that the Agency needs to support its programs; the Agency must prioritize its development activities to serve the greatest needs first. As of April 2010, management confirmed that no plans had been approved to improve CEMRS, nor had there been an analysis of the importance of CEMRS upgrades in relation to other possible projects for system development in the Agency.

9.55 Recommendation. The Canadian Food Inspection Agency should set priorities for future development of emergency information systems for animal diseases in relation to other information technology priorities and create suitable project plans if this is identified as a priority for the Agency.

The Agency's response. Agreed. The development of emergency information systems remains a high priority and will be considered within the context of the Agency's information system plans and priorities. Business requirements will be prepared and submitted for consideration through the Agency's information management/information technology governance structure.

Learning from animal disease emergencies

9.56 Looking at lessons learned after an emergency, as well as after other events, provides important information about the strengths and weaknesses of existing processes. This information can then be used to improve future responses. We examined whether the Agency had procedures in place to identify and implement lessons learned from animal disease emergencies as well as from other sources, such as training exercises. We also examined whether it uses this information to improve its readiness to respond to animal disease emergencies.

9.57 The Agency, along with its animal health program, is organized into three major branches: Science, Policy and Programs, and Operations. The Operations branch is divided into four geographical areas: Atlantic, Quebec, Ontario, and Western. This organizational structure makes it particularly important that staff in all three branches and four areas understand the lessons learned from previous animal disease emergencies and other sources and that staff apply this knowledge to their work.

Agency staff informally share lessons learned

9.58 We observed that the Agency has a number of informal ways for staff across the country and in different branches to learn and share information. Agency officials told us that one way to make sure that staff all across Canada learn about animal disease emergencies is to involve them in an emergency response. When an emergency is declared, staff members from headquarters and area offices across the country are sent to help manage the Agency's response and to share what they have learned with their colleagues. Agency staff also help with international emergencies. For example, Agency officials helped with the foot-and-mouth disease outbreak that occurred in the United Kingdom in 2001 and prepared a report that documented what they learned as a result of their participation.

9.59 The Agency also created a number of working groups to develop procedures for dealing with avian influenza; these working groups have been used to transfer the knowledge gained from managing the avian influenza outbreaks in western Canada to other regions. We examined the list of members of the working groups and found that different areas are represented, which supports the sharing of information between colleagues across Canada.

The Agency does not systematically follow up on lessons learned

9.60 We observed that that the Agency documents lessons learned in a number of ways, and there can be more than one lessons learned report for a particular event; these reports are prepared for different purposes or different audiences.

9.61 We found that, while the Agency documents lessons learned from its management of animal disease emergencies and other events such as exercises, it does not have a system that compiles all key issues and recommendations from all the various lessons learned reports. We also found that the Agency does not consistently assign priorities and responsibilities and monitor progress to make sure these issues are resolved.

9.62 We reviewed lessons learned documents from the 2004, 2007, and 2009 avian influenza outbreaks and observed that similar issues were identified during all three events, such as the need to clarify roles and responsibilities and improve information management and information technology capabilities. This observation points to the need to keep track of important lessons learned more systematically to make sure they are resolved; otherwise, the Agency's response to an emergency could be affected.

9.63 **Recommendation.** The Canadian Food Inspection Agency should assign responsibility and develop procedures to review sources of lessons learned, identify those issues that are most important to the Agency, and determine the necessary actions to address them. These actions should be tracked until they have been resolved.

The Agency's response. Agreed. The Agency will assign responsibility for coordinating the review of all emergency response and training lessons learned reports to the Office of Emergency Management. Consolidated recommendations will be submitted for consideration through the Agency's policy and programs governance structure. Implementation progress of accepted recommendations will be reported to the Agency's Audit Committee.

Conclusion

9.64 We found that the Canadian Food Inspection Agency has planned for, responded to, and learned from animal disease emergencies, consistent with the *Emergency Management Act* and emergency management standards. However, we noted areas that need improvement.

9.65 The Agency has developed policies, plans, and procedures to manage animal disease emergencies and has adjusted its approach based on lessons learned. However, it needs to improve in two areas. First, it needs to identify priorities and work plans, based on risk, for completing hazard-specific plans and procedures, and then complete the necessary work. Second, it needs to develop procedures to systematically identify and track all important lessons learned until they are resolved. Because of these two areas that need improvement, the Agency's efforts to update its readiness for animal disease emergencies may not be as successful as they could be.

9.66 We also found that the Agency managed the 2007 and 2009 avian influenza emergencies according to the policies, plans, and procedures that it had in place. Every animal disease emergency includes specific challenges that cannot always be anticipated; but, by managing each emergency according to set policies, plans, and procedures, the Agency is better able to handle them. Because each animal disease emergency is unique, the Agency's response to the 2007 and 2009 emergencies cannot be generalized to predict the Agency's response to future emergencies.

9.67 While the Agency has put much effort into improving its emergency preparedness and response since 2004, key challenges remain. For example, while the Agency has prepared a hazard-specific plan to respond to foot-and-mouth disease, it still has significant work to do to improve its readiness to manage an outbreak of the disease.

About the Audit

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by The Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

Objectives

The overall objective of this audit was to determine whether the Canadian Food Inspection Agency has planned for, responded to, and learned from animal disease emergencies, consistent with the *Emergency Management Act* and emergency management standards.

The audit sub-objectives for the two lines of enquiry were as follows:

- Determine whether the Canadian Food Inspection Agency has developed policies, plans, and procedures to manage animal disease emergencies and has adjusted its approach based on lessons learned, consistent with the *Emergency Management Act* and emergency management standards.
- Determine whether the Canadian Food Inspection Agency managed the 2007 and 2009 avian influenza emergencies consistent with its established plans and procedures.

Scope and approach

This audit examined the Canadian Food Inspection Agency's readiness to respond to animal disease emergencies, its management of avian influenza emergencies in 2007 and 2009, and whether it adjusts its approach based on lessons learned.

The audit examined the Agency's disease response activities for land-based farm animals only. It did not examine its responsibilities toward other animals, such as aquatic animals and bees. While we recognize that responding to animal disease emergencies involves many partners, the audit focused only on the Agency's actions and did not examine the actions of its key partners, such as provincial and municipal governments.

During our audit, we interviewed Agency officials at headquarters as well as key officials from regional offices who are involved in managing animal disease emergencies. We interviewed key stakeholders from the private sector and provincial governments. We also reviewed files, records, and reports, and examined information found in the Agency's emergency management system for animal diseases (Canadian Emergency Management Response Systems).

Criteria

To determine whether the Canadian Food Inspection Agency developed policies, plans, and procedures to manage animal disease emergencies and adjusted its approach based on lessons learned, we used the following criteria:	
Criteria	**Sources**
The Canadian Food Inspection Agency identifies the risks of potential animal disease emergencies consistent with the *Emergency Management Act* and emergency management standards.	• *Emergency Management Act,* section 6(1) • Emergency Management and Business Continuity Programs (Canadian Standards Association, CAN/CSA-Z1600-08)
The Agency prepares emergency management policies, plans, and procedures in respect of the identified risks consistent with the *Emergency Management Act* and emergency management standards.	• *Emergency Management Act,* section 6(1) • Emergency Management and Business Continuity Programs (Canadian Standards Association, CAN/CSA-Z1600-08)
The Agency conducts exercises and training in relation to its policies, plans, and procedures, consistent with the *Emergency Management Act* and emergency management standards.	• *Emergency Management Act,* section 6(1) • Emergency Management and Business Continuity Programs (Canadian Standards Association, CAN/CSA-Z1600-08)
The Agency conducts lessons learned in relation to its exercises, training, and management of animal diseases, including animal disease emergencies, and has updated its policies, plans, and procedures based on these lessons learned, consistent with the *Emergency Management Act* and emergency management standards.	• *Emergency Management Act,* section 6(1) • Emergency Management and Business Continuity Programs (Canadian Standards Association, CAN/CSA-Z1600-08)
To determine whether the Canadian Food Inspection Agency managed the 2007 and 2009 avian influenza emergencies according to its established plans and procedures, we used the following criteria:	
Criteria	**Sources**
The Canadian Food Inspection Agency manages selected animal disease emergencies consistent with its established policies, plans, and procedures.	• *Emergency Management Act,* section 6(1)b • Canadian Food Inspection Agency's Emergency Response Plan (May 2009, 2nd edition) • Animal Health Functional Plan, Canadian Food Inspection Agency, December 2006 • Notifiable Avian Influenza Hazard Specific Plan, Canadian Food Inspection Agency, December 2006 • Foreign Animal Disease Eradication Support Plan for Saskatchewan, 26 May 2006 • Foreign Animal Disease Emergency Support Plan—Federal/Provincial Agreement in British Columbia, 2009

Management reviewed and accepted the suitability of the criteria used in the audit.

Period covered by the audit

The main period covered by the audit is October 2009 to April 2010. However, we looked at two outbreaks of avian influenza that took place in 2007 and 2009, and some of the documents reviewed go back to 2004. Audit work for this chapter was substantially completed on 30 April 2010.

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Appendix List of recommendations

The following is a list of recommendations found in Chapter 9. The number in front of the recommendation indicates the paragraph where it appears in the chapter. The numbers in parentheses indicate the paragraphs where the topic is discussed.

Recommendation	Response
Preparing for animal disease emergencies	
9.40 The Canadian Food Inspection Agency should set priorities, based on risk, for completing hazard-specific plans and procedures for dealing with higher risk diseases. Based on these priorities, it should schedule the work and monitor the status of this work. **(9.28–9.39)**	Agreed. The Agency has recently reviewed the status of all hazard-specific plans and has prioritized them based on risk. Procedural documents that underpin the hazard-specific plans for higher risk diseases will be prioritized for development and completion based on risk. An action plan will be developed that identifies work plans and timelines for completing identified hazard-specific plans and procedures. The action plan will be monitored and progress will be reported through the Agency's policy and programs governance structure.
Responding to avian influenza emergencies	
9.55 The Canadian Food Inspection Agency should set priorities for future development of emergency information systems for animal diseases in relation to other information technology priorities and create suitable project plans if this is identified as a priority for the Agency. **(9.49–9.54)**	Agreed. The development of emergency information systems remains a high priority and will be considered within the context of the Agency's information system plans and priorities. Business requirements will be prepared and submitted for consideration through the Agency's information management/information technology governance structure.
Learning from animal disease emergencies	
9.63 The Canadian Food Inspection Agency should assign responsibility and develop procedures to review sources of lessons learned, identify those issues that are most important to the Agency, and determine the necessary actions to address them. These actions should be tracked until they have been resolved. **(9.60–9.62)**	Agreed. The Agency will assign responsibility for coordinating the review of all emergency response and training lessons learned reports to the Office of Emergency Management. Consolidated recommendations will be submitted for consideration through the Agency's policy and programs governance structure. Implementation progress of accepted recommendations will be reported to the Agency's Audit Committee.

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